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Jörg Philipp Terhechte
Editors

2011

European Yearbook of International Economic Law

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European Yearbook of International Economic Law 2011

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ISBN 978-3-642-14431-8 e-ISBN 978-3-642-14432-5
DOI 10.1007/978-3-642-14432-5
Springer Heidelberg Dordrecht London New York

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Cover design: WMXDesign GmbH, Heidelberg, Germany

Printed on acid-free paper

Springer is part of Springer Science+Business Media (www.springer.com)

Editorial

Part I of Volume 2 of the European Yearbook of International Economic Law (EYIEL) has as a new feature of EYIEL two special focuses. Whereas the first special focus concentrates on the relationship between the "sovereign" state and the global economy, the second deals with the interaction of climate change and international economic law. Taking into account the variety of topics in international economic law and thus its demands for concentration, the next issues of EYIEL will further pursue this "focus-approach". Therefore, Volume 3 (2012) will place emphasis on the focus "Ten Years of China's WTO Membership" and "Global Energy Markets and international economic law".

We are glad, Karl M. Meessen, a distinguished scholar in international law, agreed to contribute in EYIEL 2 with a distinguished essay dealing with "Governmental Decision-Making in the Global Economy". Other topics in conjunction with the relationship between the "sovereign" state and the global economy cover complex questions on the regulation of Sovereign Wealth Funds and the role of global financial institutions. Along with some contributions in EYIEL 1, we have hopefully succeeded in providing a detailed analysis of some important questions concerning the global economic crisis which has mutated into a crisis of the European Economic and Monetary Union during the last months.

The problem of climate change represents an increasingly relevant topic in the context of international economic law. In recent years a discussion on "greening" the WTO treaties aroused, deeply influencing practice and research in that field. In these days, this discussion is not solely confined to WTO law but covers all fields of international economic law. The outcome of the 2009 United Nations Climate Change Conference in Copenhagen demonstrated how difficult it still is to achieve any progress in this area. Against this background, EYIEL 2 deals with various topics in this field, e.g. relating to the problem of carbon capture and storage, biofuels under WTO law, climate labelling and WTO, environmental services and GATS and, finally, the European Union competences in the field of international environmental law.

Part II (Regional Integration), as usual, is devoted to selected questions of regional economic integration. In view of the European Union, the competences in the field of regional trade agreements are once again at the centre of important debates. Other contributions are concerned with current developments in Middle East and Africa (MENA), the future options of regional economic integration in North and South America, and the latest tendencies in Asia (especially ASEAN).

Finally, Part III (International Economic Institutions) contains an exhaustive analysis of the reform of the G 8 (now G 20) and a recent landmark decision by the Appellate Body of the WTO, in addition to an outlook on the future of the Doha Development Agenda of the WTO.

Once again, we are indebted to a great number of people, first and foremost to our contributors. The collaboration with Springer and especially with Dr. Brigitte Reschke, was – again – very positive and fruitful. We have to extend our thanks to the members of the EYIEL Advisory Board, too. Lastly, we would like to thank our academic and student assistants at the Universities of Hamburg and Passau for their invaluable support in handling the manuscripts and proofs in a very professional manner.

Passau/Hamburg
May 2010

Christoph Herrmann
Jörg Philipp Terhechte

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Part I
Topics

Distinguished Essay

Governmental Decision-Making in the World Economy

Karl M. Meessen

On asking me to discuss the role of the state in the world economy, the editors kindly accepted my preference for the term "government". Unlike "state", that term does not focus on an entity separate from us. "We the People . . . establish justice, . . . promote the general welfare . . ." is how it is put in the preamble to the Constitution of the United States of America. Government being part of society, the term "governmental" is conceived here to designate but a mode of decision-making by the people. There is, of course, no substitute for the term "state" as a noun in other contexts, for instance when the reference is to the bearer of legal rights and obligations under constitutional law or international law.

Surely, citing the Constitution of the United States of America and emphasizing the view of government as us, this essay adopts a pronouncedly democratic perspective. A Chinese author writing on the same subject in Shanghai, the Chinese equivalent to New York, is likely to perceive the government in Beijing as part of a separate entity that, however, retains residual control of every single economic decision wherever it is taken in the whole of China. In a system of autocratic capitalism, the state may, as China did some 30 years ago, generously give leave to competition with the aim of collecting the efficiency gains attributed to market economies. But that decision may also be limited or revoked at any time. Autocratic capitalism of the Chinese variety has to be seen as an alternative model to US-type entrepreneur-driven capitalism. Only time can tell which model of economic decision-making will prove more successful in the course of the twenty-first century.[1]

Writing, as it happens, in Düsseldorf rather than in Shanghai, I will first look at what it means to identify instances of governmental economic decision-making. Some of the fields where the influence on the world economy may have shifted from government to business, or vice versa, will be discussed thereafter. The survey will

[1]Halper, *The Beijing Consensus, How China's Authoritarian Model Will Dominate the Twenty-First Century*, 2010.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_1, © Springer-Verlag Berlin Heidelberg 2011

be concluded by considering what the state of governmental decision-making in the world economy may mean with regard to the constitutionalization theory of international economic law.

Forms of Governmental Decision-Making

The forms of governmental decision-making are prescribed in the constitution of the respective state. Today's democratic constitutions all follow Locke and Montesquieu in distinguishing between various branches of government:

1. The legislative branch, organized in democratically elected parliaments, deliberates and adopts laws, decides on the budget, controls the executive branch and arranges for appointments to the judiciary.
2. The executive branch of government, in both its parliamentary and its presidential variants, executes legislation and makes use of whatever scope for independent action existing laws and budgetary constraints may leave. In addition, it may have a role in the legislative process, for instance the right of initiating legislation.
3. Unlike the political branches of government, the judicial branch is not entitled to initiate proceedings on its own. A court has to wait until it is approached, either by citizens who want to settle the disputes they have among themselves or with the executive branch of government, or by the institutions or organs of the political branches of government in cases of constitutional and administrative law.

The common characteristic of the aforementioned forms of governmental decision-making is to transform a variety of diverging views into a single decision and to have that decision implemented and executed, if necessary, by taking recourse to the use of force, in both cases subject, of course, to judicial control. Private decision-making is different. Its preferred form is a contract. The conclusion of contracts presupposes voluntary consent of two or more parties. Metaphorically speaking, it takes place on a horizontal level with neither side enjoying legal superiority comparable to that of the political branches of government in governmental decision-making. The latter therefore can be imagined as a vertical process of imposing governmental acts on the respective addressees no matter whether consent is given or not.[2]

The foregoing account of governmental decision-making is incomplete. It is confined to summarizing the elementary functions of constitutional government within a state. The international dimension has to be added. There are some 193 governmental decision-makers organized in as many sovereign states. The power of enforcing their decisions ends at the frontiers of the respective state, not so,

[2]For the sociological background, see Meessen, *Economic Law in Globalizing Markets*, 2004, pp. 95 et seq.

however, the contents of their decisions. Business may therefore be easily exposed to duplicative or contradictory orders by two or more governments with respect to one and the same matter. Hardship and friction may result unless economic decision-making is exercised with a sense of restraint by way of mutual accommodation. Accommodation may take the form of treaty-making where sovereign states deal with each other just like private persons on a horizontal level. In addition, governments may establish international organizations and delegate their decision-making to them. International agreements and decisions of international organizations therefore constitute instances of governmental decision-making and must be included in any assessment of its impact on the world economy, and their influence will have to be weighed against that of non-governmental organizations (NGOs).[3]

Every phase of governmental decision-making is open to business influence, which may start with proposing the respective piece of legislation and it may eventually proceed to bending its implementation in a particular direction. Government is part of society and therefore not immune from societal influence even if that influence is exerted through bypassing or contravening existing laws. When weighing governmental versus private decision-making in the economy, note will therefore also have to be taken of the private forces inherent in the governmental decision-making process.

In view of the resulting complexity of governmental decision-making, a major simplification may be permitted: the impact of supranational organizations, that is in today's world mainly of the European Union, on economic decision-making will be totally disregarded. In its 27 member states, the European Union provides for just one more level of governmental decision-making, which is at least as exposed to business influence as governmental decision-making on member state level. Whenever henceforth an issue is identified as being subject to governmental decision-making, that finding leaves open whether, within the European Union, such governmental decision-making takes place on member state or union level.

Stagnation and Diverse Trends

Those who followed the economic press until about 3 years ago started asking themselves whether any part of economic activity was considered still to be subject to preponderant governmental influence. Wall Street and the City of London seemed engaged in an unending race to the top, with the top in that case defined as top liberalization and top profitability. According to some of the same media, the outbreak of the financial and economic crisis is now supposed to necessitate an urgent return of government to assuming responsibility in the world economy. As so often, both views reflect an exaggerated account of the facts: neither was there ever a complete "retreat of the state"[4] before 2008, nor would it make sense to put

[3]Reinicke, *Global Public Policy, Governing Without Government?*, 1998.

[4]Strange, *The Retreat of the State, The Diffusion of Power in the World Economy*, 1996.

government today in complete control of the world economy. Instead of looking at aggregate figures, such as the state quota in the gross national product, the assessment will proceed by highlighting structural developments with regard to various aspects of economic law and institutions.[5]

Trade Liberalization Stalemated at a High Level

With the entry into force of the WTO agreements[6] on 1 January 1995, trade liberalization reached an unprecedented stage. That achievement, however, was soon to be overshadowed by the failure to achieve further progress ever since. It was the newly established WTO itself that failed to move on as rapidly as it first anticipated. The WTO's quest for universality notwithstanding, the only further steps of liberalization were taken by way of regional and bilateral agreements.[7] In addition, there were waves of unilateral measures of liberalization spreading across the world. But they stand to be revoked unless they are confirmed by a multilateral instrument.[8] Also, the GATT's, and later the WTO's, prioritizing trade policy over environmental and even social policies proved counterproductive. Instead of making civil society its ally, the WTO, for all its resilient fight against powerful protectionist lobbies, earned the enmity of important NGOs.[9] None the less, despite the current freeze of global trade liberalization, WTO law has assumed centre stage and, as will be pointed out later, indirectly and yet most effectively contributes to strengthening the role of private business in economic decision-making.

The confinement of WTO law to its core issues of trade liberalization is reflected in the reduced ambition of the International Law Association's International Trade Law Committee (ITLC) to incorporate the study of the "near abroad" of non-trade subject matter. In 1996, which was the year following the entry into force of the Marrakesh agreements, the ITLC, like the WTO, set out to embrace all sorts of borderline subjects ranging from intellectual property, antitrust, environment and investment to human rights, the first four of them incorporated under their WTO label for "trade-related . . . measures": TRIPS, TRAMS, TREMS and TRIMS.[10] In 2002, all of those subjects were again referred to after the opening of the Doha round of

[5]For a broad survey, see, e.g., Donges/Freytag (eds.), *Die Rolle des Staates in einer globalisierten Wirtschaft*, 1998.

[6]Marrakesh Agreement Establishing the World Trade Organization of 15 April 1994 (including annexes with set of multilateral and plurilateral agreements), OJ 1994 L 336/1.

[7]For a critical account, see Bhagwati, *Termites in the Trading System*, 2008.

[8]Expressing concern in that respect, Mandelson, Doha a posteriori, in: Hohmann (ed.), *Agreeing and Implementing the Doha Round of the WTO*, 2008, p. 11.

[9]Irwin, *Free Trade under Fire*, 2002, pp. 179 et seq.; for a recent general account, see Senti, Welthandelsorganisation (WTO), 2009, pp. 151 et seq.

[10]Committee on International Trade Law, Second Report, International Law Association, Report of the 67th Conference, 1996, p. 247.

WTO negotiations.[11] Six years later, most of the acronyms had gone and the expansion of WTO subject matter was cut down to some talk about human rights.[12]

The mercantilist instincts of member state governments, which had already strained the difficult process of negotiating the Uruguay round (1986–1993), were reinvigorated by the current financial and economic crisis. Wordy pledges condemning protectionism reiterated at summit conferences increasingly look just like that.[13] Whether the Doha development round of negotiations, which started in 2001, will be concluded any time soon is an open question at the time of this writing (May 2010).

In a way, trade liberalization has become a victim of its own success. The current level of liberalization in the trade of industrial goods was high enough to intensify the competition for inward investment. Driven by goals of employment policy, governments have always been involved in a competition of systems.[14] That competition has now become a dominating feature of worldwide economic development:

1. In most host states for investment, the dismantling of tariffs and non-tariff barriers at its present degree makes "tariff hopping" an unnecessary exercise. Locations for production can be chosen in relative independence of governmental trade restrictions.
2. Domestic tax, labour and environmental laws, along with offering infrastructural services and skilled labour, constitute the main parameters to attract and retain inward investment.
3. As to factor mobility, capital can move freely whereas, outside the European Union, cross-border movement of labour remains heavily restricted by government control.

In view of possible extensions or contractions of governmental decision-making, trade liberalization has temporarily been stalemated at the relatively high level reached at the time of the entry into force of the WTO agreements. On the one hand, although business can move freely in liberalized industrial markets, governments, though influenced by NGOs, still have at their disposal numerous instruments of governmental decision-making that have not yet, or not yet entirely, been outlawed by the WTO agreements, such as levying countervailing duties and granting state aid. Also, agriculture and services remain insufficiently covered. On the other hand, the beneficial effects of trade liberalization not only intensified the intergovernmental

[11] Committee on International Trade Law, Fifth Report, International Law Association, Report of the 70th Conference, 2002, p. 659.

[12] Committee on International Trade Law, Eighth Report, International Law Association, Report of the 73rd Conference, 2008, p. 708.

[13] See, e.g., Group of Twenty, Global Plan for Recovery and Reform, 2 April 2009; for a reiteration, see Group of Twenty, Leaders' Statement, 24–25 September 2009, http://www.whitehouse.gov/the_press_office/leaders-statement-on-the-Pittsburgh-summit.

[14] See generally Meessen, Prinzip Wettbewerb, Juristenzeitung 64 (2009), pp. 697, 703 et seq.; Meessen/Bungenberg/Puttler (eds.), *Economic Law as an Economic Good, Its Rule Function and its Tool Function in the Competition of Systems*, 2009.

competition of systems but also gave it a definite turn in the direction of providing for more liberalization on a unilateral, bilateral and regional level. Although falling short of the ideal of universality, the somewhat messy legal situation, which may be more commensurate with the diversity of economic conditions and political aspirations, is apt to gradually reduce governmental decision-making in the world economy. Furthermore, competition of systems for more liberalization has contagious effects beyond cross-border trade as the following subsections will show.

The Growing International Law Umbrella Protecting Foreign Investment

The proliferation of bilateral investment treaties (BITs) during the last couple of decades, taking their number to 2,676 at the end of 2008,[15] has thoroughly changed the landscape of protecting foreign direct investment. That field of international law had before mainly been known for its controversies about a couple of vague rules of customary international law.[16] Meanwhile, the substantive law protection of foreign investment is increasingly granted by a number of recurring treaty clauses.[17] One of them is the so-called umbrella clause. It makes investment itself the object of protection. That term is broader than the notion of property. Contractual commitments may be included to the extent expenses were incurred. The coverage of contractual rights even leads to the question whether restitution is about to replace compensation as the appropriate remedy.[18] Furthermore, the geographic coverage of the one or other umbrella clause may have considerably been enlarged by most-favoured-nation (MFN) clauses, which can make the protection granted by a single umbrella clause subscribed to by state A available to every state with which it has concluded a BIT that contains an MFN clause.

Formerly, acceptance of commitments of substantive law did not necessarily guarantee their enforcement. Within the BIT network, that is no longer the case. In BITs, foreign investors are usually offered fork-in-the road clauses whereby, in the case of a dispute, they can choose between presenting their claim to the national courts of the host state of the investment, on the one hand, and resorting to arbitration, on the other. Speed, neutrality and expertise clearly advantage arbitration. In the many cases where ICSID arbitration is provided for, the 1965 World

[15]UNCTAD, World Investment Report 2009, Part I, p. 32.

[16]Meessen, International Expropriation Law in the Conflict Between North and South, Law & State 19 (1979), p. 106 et seq.

[17]Meessen, Streitigkeiten über Auslandsinvestitionen vor völkervertraglichen Schiedsgerichten, in: von Verschuer/Gres (eds.), *Liber amicorum für Alexander Riesenkampff*, 2006, p. 93; for an excellent survey, see International Law on Foreign Investment, Final Report, International Law Association, Report of the 73rd Conference, 2008, p. 752.

[18]For a cautious remark in that direction, see International Law on Foreign Investment, Final Report, International Law Association, Report of the 73rd Conference, 2008, p. 793.

Bank Convention[19] makes arbitral awards enforceable in all of its member states and thereby additionally justifies favouring arbitration.

In fact, a large body of arbitral case law has meanwhile developed. That case law, even though related to differently worded treaties, provides a degree of legal certainty previously unknown in the field of protection of foreign investment. In the so-called new international economic order of the 1970s, a number of resolutions of the UN General Assembly sought to leave the protection of foreign investment to the discretion of the expropriating state.[20] It is a real climate change that has taken place during the 30–40 years that have lapsed since then.

What does all this mean with regard to governmental decision-making? A tentative answer might highlight two aspects:

1. Host state "police powers", as they are called in BIT doctrine, have become effectively curbed by enforceable private rights.
2. The enhanced protection of investment provides for decentralized market structures, which favour private decision-making in the world economy.

Both those aspects are clearly at the expense of governmental decision-making. In fact, the curbs imposed on governmental decision-making are increasingly resented by politically adventurous host state governments. They feel tempted to terminate treaty protection. But undercapitalized host states, aware of that competition for more liberalization and yet desperately in need of inward investment, fear for the planned investment to go to any other state that might offer a higher standard of protection. And the wealthy ones of those host states that can afford some idiosyncratic behaviour have second thoughts, too. They often harbour sovereign funds and also parent companies of multinational enterprises that have themselves become worldwide investors and hence feel a need for treaty protection. An understandable sense of reciprocity makes them reluctant to renounce the international law umbrella protecting foreign investment.[21]

Proliferation of Competition Laws

In 1945, there was just one state in the world prohibiting restraints of competition and providing for merger control under competitive aspects. The reference, of course, is to the USA and to what is there called antitrust law. Today, 65 years later, there are about 100 states whose legal systems include legislation on

[19]Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, 18 March 1965, 575 U.N.T.S. 159.

[20]Meessen, International Expropriation Law in the Conflict Between North and South, Law & State 19 (1979), p. 106 et seq.

[21]For a historical survey coupled with a timely warning against overreaching in dispute settlement agreements, see Crawford, Continuity and Discontinuity in International Dispute Settlement, J. Int'l Disp. Settlement 1 (2010) 1, pp. 3 et seq.

competition. Some of those laws may exist just on paper. Most of them, however, are being enforced with some vigour. Hence, they considerably influence the extension of the spheres of governmental and private decision-making. The exact course of the boundary line between the two types of decision-making, however, has to be assessed in a case-by-case analysis with due regard to the respective legal and economic environment. When conducting such an analysis, account has to be taken of some peculiarities of competition law. They will be outlined in the following.

Unlike international trade law, rules of competition law have not been made part of the directly applicable law of international agreements. The only exceptions are the Treaty Establishing the European Economic Community of 1957 and its predecessor agreement on the European Coal and Steel Community of 1951. In both cases, the dismantling of governmental trade barriers to forge a customs union was supplemented by rules of competition law addressed to enterprises so as to transform the customs union into a single market, as it has later been called. Those rules, along with additional rules of secondary law, still form part of the law of the European Union. On a global level, several attempts were undertaken to establish common rules of competition law. To date, none of them have proved successful. Spontaneous convergence, driven by the competition of systems, was considered a satisfactory and, in this author's opinion, even preferable substitute for the imposition of binding obligations of international law to that effect.[22] In addition, agreeing on a meaningful "world competition law" would be a kind of a squaring-the-circle undertaking.

The basic concept of international trade law is quite straightforward: one needs to identify the goods and services as well as the geographic setting and can then decide if and to what extent the flow of trade is to be facilitated by the removal of tariffs and non-tariff barriers. By the partial or total removal of governmental restrictions, business conduct is discharged from obligations, whereas legislation on competition law presupposes the imposition of obligations on business conduct by outlawing those types of conduct that are considered to be in restraint of competition already or, in merger control law, to be establishing market structures conducive of such restraints. In other words, competition legislation is a matter of making new laws rather than of just removing old ones, however complicated intermediate stages of abolishing trade laws can turn out to be.[23]

Prima facie, the competition laws of the world resemble each other. On closer scrutiny, some differences can be noted. Already the legislative goals may differ:[24] Is it nothing but Pareto efficiency that has to be brought about? Or should business

[22]Meessen, ICN Accompanied Convergence, Instead of WTO Imposed Harmonization of Competition Laws, in: Hohmann (ed.), *Agreeing and Implementing the Doha Round of the WTO*, 2008, p. 223; id., Competition of Competition Laws, Nw.J.Int'l L. & Bus. 10 (1989), pp. 17 et seq.

[23]Meessen, *Economic Law in Globalizing Markets*, 2004, pp. 131 et seq.

[24]For the goals and sanctions in European and German competition law, see Meessen, Einführung, in: Loewenheim/Meessen/Riesenkampff (eds.), *Kartellrecht, Europäisches und Deutsches Recht*, (2nd ed.) 2009.

conduct only be prohibited to the extent such prohibitions serve consumer protection as well? Also, secondary goals, such as preserving the freedom of the press, ensuring the countrywide supply of basic services, etc. may, as the case may be, expand or reduce the scope of application of the substantive rules of competition law. Especially, exempting particular industries from the application of competition law opens up a highly politicized field of fine-tuning in the making of competition law governments are reluctant to renounce.

Further differences relate to the enforcement of competition laws. A difference of principle, for instance, exists between those states that exclusively rely on governmental enforcement including sanctions of criminal law and those that also provide for effective private remedies so as to support, although sometimes actually hampering, government enforcement. Thus, the availability of private actions for damages may jeopardize the overall effectiveness of enforcement whenever leniency is supposed to encourage whistle-blowing but fails to immunize against private sanctions. Also, governmental enforcement may differ widely when it comes to controlling the abuse of dominant positions. Governmental control of prices charged by dominant players may whenever necessary costs and appropriate profit margins are determined at the desk of enforcement officers turn into that Hayekian nightmare of bureaucratic "pretence of knowledge" that prevents the "discovery function" of competition from evolving its beneficial effects.[25]

The spontaneous proliferation of competition laws has greatly enlarged the realm of private decision-making in the economy. And yet, government has retained its foot in the door, with respect to both law-making and enforcement. It has again to be stressed that it is WTO law that, as was shown above, intensified the competition of systems and thereby promoted liberalization well beyond cross-border trade, and that it is the reinforced protection of foreign investment that, as was also shown above, provides the right market structure for lively competition by increasing the number of players also in those states that cannot, as the USA did until 1945, rely on the huge dimension of their domestic market.

Financial Regulation in the Wake of the Banking Crisis

The occasional failure of individual businesses is a necessary element of dynamic competition. Joseph Schumpeter called it "creative destruction".[26] When, however, one ailing bank that actually is too big, or too interconnected, to be allowed to fail threatens to make many other banks tumble like dominoes, we are confronted with a case of market failure.[27] According to industrial organizations theory, markets

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[25]von Hayek, The Pretence of Knowledge, Swed. J. Econ. 77 (1975), p. 433; id., *Wettbewerb als Entdeckungsverfahren*, 1968.

[26]Schumpeter, *Capitalism, Socialism and Democracy*, 1975, p. 83.

[27]For the concept of market failure and its remedies, see Cassidy, *The Logic of Economic Calamities*, 2009.

recover by themselves. But recovery takes its time, and time entails transaction costs that are too high to be tolerated in democratically organized states. Hence, governments are called upon to intervene in situations of market failure. In fact, when governments fail to intervene even though intervention seems possible, market failure must be found additionally to lead to state failure.[28]

When the investment bank Lehman Brothers failed in 2008, governments were aware of that obvious responsibility, and yet they decided not to intervene in that case. But they took up doing so in the next couple of cases and thereby avoided triggering a domino effect. With regard to the boundary line between governmental and private decision-making in the economy, one may ask what kind of action had actually been taken and what impact it had and is likely to have soon on the share of governmental decision-making in the world economy.

So far, crisis management has been characterized by a discrepancy between solemn calls for multilateral regulatory action and a practice of actually taking sundry individual measures on a national or at best European level. All of those measures involved capital injections of taxpayers' money in a variety of forms: acquisition of equity, conclusion of loan agreements, extension of guarantees and supply of central bank funds at minimal interest rates. Some banks were made subject to governmental control, others quickly regained complete independence, such as the investment house Goldman Sachs, which in 2008 was famously rescued from illiquidity with the support of its former chief executive officer Hank Paulson, who had meanwhile become US secretary of the treasury, but, as early as 2009, after having paid back the government's loan, Goldman Sachs again reached its 2007 level of extraordinary profitability.[29]

In the financial sector, governments have meanwhile been left with substantial additional holdings of equity and debts, whose value largely depends on future developments. In that respect, governmental involvement in the economy has at least temporarily been expanded with a corresponding contraction of the room for private decision-making. Financial regulation that would help cure current ills and prevent the outbreak of future crises of a like kind is still wanting.

On a multilateral level, the regulatory reaction to the recent crisis has been particularly slow to materialize. Even the efficiently organized Basel II Committee of central banks and supervisory authorities published its proposals "to strengthen the resilience of the banking sector" only in December 2009 and hopes to have them agreed upon in 2010 and implemented by the end of 2012.[30]

On a national (or European) level, regulatory action, though envisaged, is making little progress. As ever, there are several factors explaining the low regulatory yield so far reached on a national level. One of them certainly is the strength of the banking

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[28] Meessen, Wettbewerb – richtig dosiert, Wirtschaft und Wettbewerb 60 (2010), pp. 6 et seq. (reprinted in Wirtschaft und Verwaltung 13 (2010)).

[29] Financial Times, 11 November 2009, p. 16; Financial Times 19 November 2009, p. 9.

[30] Basel Committee on Banking Supervision, International framework for liquidity risk measurement, standards and monitoring, Bank for International Settlements, Consultative Document, 17 December 2009, http://www.bis.org/publ/bcbs165.htm.

lobby. Another one is the persistence of mercantilist attitudes. Governments wish to attract additional financial activities and therefore avoid alienating the key players in the financial markets. In the absence of agreement on which measures to take, the competition of systems became a pretext for non-action.

On a unilateral basis, it would take some ingenuity to design financial regulation that is both effective and sufficiently attractive within that global competition among financial centres.[31] A far-reaching proposal of "narrow banking" was made by President Obama in his State of the Union Address of 27 January 2010.[32] The scheme had been elaborated and was later detailed by the former chairman of the US Federal Reserve Paul A. Volcker,[33] but it has not yet been adopted, let alone, put into practice. Banking in the United States had fared not too badly under that system introduced by the Glass–Steagall Act in 1933 and brought to an end by the Clinton administration in 1999. Low-risk and high-risk business might indeed have to be assigned to separate banks. Only then will the taxpayer be able to relax and enjoy the benefits of low-risk loan business while leaving high-risk investment business to shareholders and stakeholders aware of what might happen. The dividing line, of course, need not follow the Glass–Steagall Act. It has to be redesigned in view of today's array of banking activities and financial instruments. It may well be the only type regulation in conformity with market principles,[34] and why should the competition of systems not be heading for those principles in that particular case?

Informal Forms of Intergovernmental Decision-Making

The concept of three intergovernmental organizations with an economic mandate elaborated towards the end of the Second World War continues to prove its effectiveness. The financial crisis has again provided a central role for the International Monetary Fund (IMF). The World Bank continues to offer its funds and its expertise to the developing world and has meanwhile been joined by functional clones with a more limited geographic coverage, such as the European Bank for Reconstruction and Development and the Asian Development Bank. The latecomer among the three, the WTO, acquired fully fledged organizational status only when, on 1 January 1995, it became the successor to the GATT Secretariat, which by then had administered the provisionally applicable General Agreement on Tariffs and Trade (GATT) for half a century. Given its broad mandate, the WTO might have aspired to the elevated status

[31]Arner, The Competition of International Financial Centers and the Role of Law, in: Meessen/Bungenberg/Puttler (eds.), *Economic Law as an Economic Good, Its Rule Function and its Tool Function in the Competition of Systems*, 2009, p. 193.

[32]Remarks by the US president in the State of the Union Address, 27 January 2010, http://www.whitehouse.gov/the-press-office/remarks-president-state-union-address.

[33]Statement of Paul A. Volcker before the Committee on Banking, Housing, and Urban Affairs of the US Senate, 2 February 2010.

[34]Meessen, Wettbewerb – richtig dosiert, Wirtschaft und Wettbewerb 60 (2010), pp. 13, 14.

of the leading economic organization but, having entertained an ambition for higher goals without reaching them, it now looks to be just on par with its well-established elder sisters. Its enlarged legal regime has, however, been successfully consolidated especially by virtue of the greatly improved dispute settlement system and is certainly worthy of being made the focus of an American Law Institute's project examining and possibly restating the "principles of world trade law".[35]

"From global law to global government" could have been the slogan to match the aspirations of WTO enthusiasts. In fact, extrapolating the impressive development that substantive international trade law had taken during the Tokyo and Uruguay rounds, one was led to wonder whether the WTO would soon proceed to adopt elements of supranational decision-making as the European Economic Community did when, in the 1960s and 1970s, it developed from a customs union to an economic decision-maker in its own right. Nothing of the kind happened. Whether its rightly praised system of dispute settlement, which seemed the only example for decision-making by the organization rather than its member states, will eventually grow to emancipate from the present limbo of diplomatic and judicial procedures remains to be seen.[36]

For the time being, the trend is moving towards more, not less, informality in intergovernmental decision-making. Thus, it is not always the national governments themselves that organize intergovernmental cooperation, which has the advantage of pragmatically focusing on the problem to be solved rather than on producing political showcases. Two examples may illustrate the point:

1. The Bank for International Settlements (BIS) was founded by central banks in 1930. The original task was to organize the repayment of German World War I reparation debts in the wake of the 1929 crash at the New York stock exchange. The BIS, having thereafter adopted various functions, most of them similar to those of the IMF, is today best known for its Basel Committee, which was mentioned in the above section "Financial Regulation in the Wake of the Banking Crisis". The Basel Committee's task is to set standards of financial regulation. Those standards are not formally binding and hence have to be incorporated into the various national regulatory regimes, be they voluntary or obligatory. Yet, directly addressing banks and their accountants, the standards provide for a degree of uniformity and transparency essential for the functioning of the worldwide financial system.
2. Governmental agencies enforcing competition law, some of them operating in considerable independence from their respective national governments, followed the pattern of cooperation between central banks and decided to institutionalize their cooperation in the loose form of the International Competition Network and the European Competition Network.[37] Both networks provide a platform for the exchange of views on competition law in general and for the handling of particular

[35] http://www.econ-law.se/Description%20ALI%20project.htm.

[36] Weiss, Reforming the Dispute Settlement Understanding, in: Hohmann (ed.), *Agreeing and Implementing the Doha Round of the WTO*, 2008, p. 269.

[37] See, e.g., Todino, International Competition Network, World Competition 26 (2003) 2, p. 283.

cases in cross-border situations that are of increasing concern to a great number of national enforcement agencies. Both traditional infringement cases and merger control cases have an impact on many national economies at a time. Early cooperation within the networks helps avoid unnecessary friction, which might otherwise lead to conflicts of jurisdiction.[38] Furthermore, administrative resources are saved by focusing investigation on those countries where the main players can be compelled to produce witnesses and documentary evidence with whatever problems with regard to the protection of business secrets may be involved.[39]

In some contrast to such agency cooperation, one should mention the "G" gatherings. The capital letter *G* stands for "group" and may be combined with the respective number of member states, ranging from G2 to G20. Member states were originally only represented by their heads of state or government until the ministers of finance of the group started organizing additional meetings of their own. The "G" meetings were intended to provide an occasion for an informal personal exchange of views of those in charge of the respective state. Meanwhile, the meetings have become just another item on the circuit of headline-grabbing conferences. Their continued effectiveness is open to doubt. Furthermore, they are starting to be rivalled by meetings of the BRICS group of countries comprising Brazil, Russia, India, China and, somewhat tentatively, South Africa. It is the BRICS group where China, without being irritated by the ever so dominant presence of the USA, has an occasion to promote its views of a politically controlled market economy.[40]

The agenda of the G meetings no longer focuses on current issues of economic policy but may cover any general policy item. The communiqués terminating those meetings – two examples were quoted above[41] – nowadays seem to matter most when, as now happens even at secluded conference venues, the meeting was accompanied by ritualized rioting often more or less openly backed by NGOs. In fact, it is now the confrontation of governmental policies with militant public opinion that accounts for the impact of the respective meeting on public opinion clearly dwarfing the perceived outcome of former chimney-type deliberations.

Trying to influence the world economy, interaction of intergovernmental organizations and civil society works both ways. For a current example, one might refer to the attempt of the UN Human Rights Council to enlist business as its agent for the promotion of human rights. In an approach of "principled pragmatism", John Ruggie, acting as the UN secretary-general's special representative, is preparing a most comprehensive report on what he calls the "protect, respect and remedy" framework to promote human rights through transnational corporations.[42] Preempting violations

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[38]Meessen, Internationales Kartellrecht der EU, in: Loewenheim/Meessen/Riesenkampff (eds.), *Kartellrecht, Europäisches und Deutsches Recht*, (2nd ed.) 2009.

[39]Meessen, *Economic Law in Globalizing Markets*, 2004, pp. 245 et seq.

[40]See note 1 and the accompanying text.

[41]See note 13 and the accompanying text.

[42]Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, 9 April 2010, UN Doc.A/HRC/14/27.

of human rights by making them part of corporate culture certainly is an imaginative and promising approach. Informality need not stand for ineffectiveness.

In sum, it seems too early to predict the medium-term to long-term effects of the current financial crisis on the course of the boundary line between governmental and private decision-making with an impact on the world economy. On a short-term basis, the private sector clearly is on the losing side but the widely spread esteem for the market mechanism and, above all, budgetary constraints may yet make governments come up with financial regulation that is susceptible to reducing the systemic risk instead of reinforcing the moral hazard by confirming the expectations of financial players to be eventually bailed out at the expense of taxpayers.

Constitutionalization of the World Economy?

The above attempt at demarcating the dividing line between governmental and private decision-making in the world economy was not exhaustive nor was it possible to discuss any of the issues looked at in greater depth. The mixed results of the survey – stagnation here, shifts in the direction of a greater share of private decision-making there – do not stand to be contradicted in principle by further research. After all, for all its flexibility, economic practice was found to be less volatile than ideological perception, which is readily swinging back and forth between adoring and abhorring market economies. This being a yearbook on international economic law, it may be appropriate to proceed to drawing some tentative conclusions with regard to the theory of international economic law.

For quite some time, international law has been found to be undergoing a process of constitutionalization. That theory has a firm basis in the astonishing development the protection of human rights has taken since the end of the World War II. Despite references to human rights in the Charter of the United Nations and despite the unanimous adoption of the Human Rights Declaration of 1948, the UN General Assembly failed for many years to proceed beyond the ritualized adoption of resolutions "expressing its deep regret . . . that the Government of the Union of South Africa has not responded to (its) appeals that it reconsider governmental policies which impair the right of all racial groups to enjoy the same fundamental rights".[43] That softly-softly approach to fighting apartheid was based on the recurring argument not only of South Africa, which defended its policy, but also of France, Portugal and the United Kingdom, which criticized that policy, the protection of human rights had to be considered an internal matter outside UN jurisdiction under Article 2 paragraph 7 of the UN Charter.[44]

Today, not only has apartheid become a matter of history but violations of human rights can nowadays be addressed by reference to universal conventions

[43]See e.g. Resolution 1375 (XIV) of 17 December 1959.

[44]For the report of the debate preceding the adoption of Resolution 1375 (XIV), see UN yearbook 57 (1959).

on human rights, to a number of regional human rights conventions with a high degree of enforceability, to international conventions providing for the criminal prosecution of persons committing crimes against humanity and, above all, to a worldwide political culture investigating violations of human rights and demanding their sanctioning wherever they may occur.[45] The *erga omnes* concept, by which the ICJ distanced itself from its denial (in 1966!) of Ethiopia's and Liberia's right to have humanitarian conditions examined in today's Namibia[46] at the occasion of its Barcelona Traction judgement of 1970,[47] has truly become an element of world law. Thus, attention has now turned to developing imaginative ways of how to use judicial and extrajudicial means for the proactive implementation of human rights standards also in the context of private and governmental decision-making in the world economy.[48] International law is no longer considered a body of legal rules made by states, providing legal rights to states and imposing legal duties upon states. Human rights have become part of an international constitution.[49] With regard to its stability, the direct applicability of its rules and the degree of their public acceptance, that part of international law will be compared with equivalent features of national constitutions.

Yet, has a similar development taken place in international economic law? A quarter of a century has passed since Jan Tumlir, a Czechoslovak economist and staff member of the GATT Secretariat, put forward his thesis with regard to the constitutionalization of international trade law.[50] Actually, his point was *de lege ferenda*. Acknowledging the advantages of trade liberalization, he was aware of how difficult it was to translate that mainstream position of economic theory into political practice. Protectionist forces always had the backing of domestic lobbying, making special interests regularly defeat the general interest reflecting that particular proposition of trade theory. In his view, the logical response was to outlaw protectionism by rules of trade law by giving them constitutional ranking. In view of the progress of international trade resulting from the entry into force of the WTO agreements and the enlargement of WTO membership, it was but a small step to move from that theory *de lege ferenda* to one attributing features of constitutional

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[45]For a comprehensive survey, see Kälin/Künzli, *The Law of International Human Rights Protection*, 2009.

[46]ICJ, South West Africa Cases, Ethiopia v. South Africa, Liberia v. South Africa, Judgment of 18 July 1966, I.C.J. Reports cons, 50 (1966); for a rejection of the Court's view, see diss. op. Jessup, ibid., at pp. 323 seq.

[47]ICJ Case concerning the Barcelona Traction, Light and Power Company Ltd., Belgium v. Spain, 2nd Phase, Judgment of 5 February 1970, I.C.J. Reports 3.33 (1970).

[48]Ragazzi, *The Concept of International Obligations Erga Omnes*, 1997.

[49]Frowein, Konstitutionalisierung des Völkerrechts, Berichte der Deutschen Gesellschaft für Völkerrecht 39 (2000), p. 427.

[50]Tumlir, The Need for an Open Multilateral Trading System, World Econ. 6 (1983), pp. 393, 403 et seq.

law to existing rules of trade law.[51] After all, human rights theory had also preceded the development of the *lex lata* reported above.

Where are we now? The WTO agreements have become a bedrock of cross-border trade liberalization. But they are still not directly applicable. This fact is matched by the lack of the accessibility of the WTO's dispute settlement system to private parties and also by government involvement in the enforcement the decisions rendered by the WTO Dispute Settlement Board with regard to WTO Panel and Appellate Body reports. Furthermore, unlike human rights, the rationale of international trade law cannot be considered to have been generally accepted in political practice. On the contrary, the effects of every new rule, be it multilateral, be it bilateral or be it unilateral, are calculated in a case-by-case analysis as to which industry is to benefit and which one is to suffer possible drawbacks. The drawbacks and the benefits are then compounded countrywise to assess the national interests with regard to the rule at issue.

Outside trade law, even fewer features of economic law indicate an ongoing process of constitutionalization. In investment law, legal stability stands or falls with the commonality of interests. BITs are susceptible to being terminated at any time. If a major development of that kind has not yet occurred, the reason cannot be found in the binding force of the rules but rather in the political pressure exerted by the competition of systems for capital investment, in some cases, supplemented by an interest in reciprocal protection. Furthermore, basic acceptance of the need to protect private property is neutralized, if not outweighed, by the perceived necessity of giving government sufficient leeway for economic policy-making. Financial regulation and the supervision of banks, rating agencies and accountancy firms have not even been embodied in legally binding rules of international law. Competition law, too, continues to be exclusively embodied in national or supranational law.

At the time being, therefore, the boundary line between governmental and private decision-making in the world economy is not constitutionally predetermined. It is for each state to observe or shift that line in the one or other direction as a matter of democratic policy-making rather than of first ascertaining and then implementing principles of an emerging constitution of international economic law. "Bottom-up" economic and political reasoning, not "top-down" constitutional deduction, should carry the day. Constitutional argument, in its dependence on time-honoured tenets, may not even be ideally suited to solve such economic problems as trouble us today and as may arise in the future. Flexible reactivity in a process of trial and error seems preferable. And as for the theory of international economic law, the mix of governmental and private decision-making we found to prevail well reflects the needs of a dynamic development of the world economy.

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[51]Petersmann, Rights and Duties of States and Rights and Duties of Citizens, Towards the "Constitutionalization" of the Bretton Woods System Fifty Years after its Foundation, in: Beyerlin (ed.), *Recht zwischen Umbruch und Bewährung. Festschrift für Rudolf Bernhardt*, 1995, p. 1087; Cottier, The Constitutionalism of International Economic Law, in: Meessen/Bungenberg/Puttler (eds.), *Economic Law as an Economic Good, Its Rule Function and its Tool Function in the Competition of Systems*, 2009, p. 317.

Central Bank Challenges in the Global Economy

Fabian Amtenbrink

Introductory Remarks

There are few institutions linked to the exercise of public power in the economic sphere that have stood the test of time for as long as central banks.[1] Indeed their origins can be traced back to the seventeenth century when in 1668 the Swedish 'Bank of the Estates of the Realm' the forerunner of todays Riksbank was established by the Riksdag, at the dawn of two major armed conflicts with neighbouring Denmark. Soon thereafter, in the midst of the Nine Year War between England and France the Bank of England was established by an Act of Parliament.[2] Other European countries such as France and the German Reich would follow suit in due course.[3]

Asserting that the role of central banks has changed in the course of their long history is hardly original. These changes can be observed both with regard to their main tasks, as well as their ownership and (corporate) institutional structure. A number of central bank systems have emerged from private corporations ((joint-) stock companies) that were initially set up with the aim to raise capital for the financing of wars thus acting as the quasi-banker of government, while at the same time undertaking commercial banking.[4] Eventually these banks would become public corporations.[5] Other banks were set up as public corporations from

[1] Generally with regard to the development of central banking, see Siklos, *The Changing Face of Central Banking*, 2002.

[2] The Bank was founded under the title 'The governor and Company of the Bank of England' and granted royal charter on 27 July 1694.

[3] The Banque de France was set up in 1800, whereas in the German Reich the Reichsbank, the forerunner of the Bundesbank, was only established in 1875.

[4] Namely in Sweden, England and the Netherlands.

[5] Such as the Bank of England and De Nederlandse Bank.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_2, © Springer-Verlag Berlin Heidelberg 2011

the start.[6] The modification of the structure of the banks can be linked to the evolution of their tasks. Initially often set up to functioning as commercial entities they would eventually be charged with the issuing of currency and take on lender of last resort functions. Central banks became responsible for the conduct of monetary policy, albeit initially often subject to direct government supervision.

The principal role of central banks in the conduct of economic policy of a country also explains to some extent the trend towards nationalization of these institutions that can be observed namely in the first half of the twentieth century. However, a considerable number of central banks, including most prominently the Banks of the Federal Reserve System remain shareholder-owned.[7] The legal bases of central banks reflected this function essentially by defining and delimiting the exercise of authority in line with what can be observed for other institutions that exercise public power. The definition of monetary policy objectives and the institutional structure of the bank, including the relationship with government, became central features of central bank legal bases. As the sole issuers of currency, certainly from the second half of the last century central banks also had a role to play beyond the national sphere mainly through foreign exchange rate operations and the participation in different international organizations and fore, such as the International Monetary Fund, the Bank for International Settlements and, more recently, the G-8 and G-20 summits.

When reflecting on the changing role of central banks in the global economy three interconnected developments can be observed, including globalization, regionalization and the global financial crisis. The hypothesis at the outset is that these developments which are to a considerable extent beyond the sphere of influence of any one central bank or indeed national government can have a decisive impact on the (constitutional) legal position of central banks and their foremost task, as it is currently understood, that is the conduct of monetary policy. This contribution offers a panoramic view of selected issues linked to the institutional position and main monetary policy task(s) of central banks and thus does not aim at an all inclusive legal and/or economic analysis of all tasks that are or odd to be associated with central banking.

Globalization

In the context of economic developments globalization may refer to "... the processes involved with the emergence of a global economy characterized not only by the opening of markets and the rapid expansion of trade, but moreover

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[6]Such as the Reichsbank, the forerunner of the German Bundesbank.

[7]The South African Reserve Bank may serve as an example of a shareholder-owned central bank whose status has recently come under pressure. See Press release on the nationalization of the South African Reserve Bank of 25 January 2010, available at http://www.reservebank.co.za (last accessed 7 May 2010).

also of the removal of financial market restrictions and free capital flow on a global scale."[8] Capital flow takes on namely the shape of Foreign Direct Investment leading "... to an internationalisation of production processes and new ways of doing business as companies have established affiliates abroad both to gain access to foreign markets and to reduce input costs."[9] Central banks face several challenges. Firstly, there is an increased pressure to bring national laws and practices relating to macro-economic governance in line with internationally recognised standards and best practice. Moreover the regional pooling of monetary policy tasks has resulted in a reformulation of the missions of central banks.

Towards Global Standards and Practices

Ohler has pointed out rightly that "From a legal point of view, the existence of internationally open markets is surprising insofar as there exist no relevant treaty rules under international law imposing a general obligation on states to guarantee free movement of capital", pointing furthermore out that states "... unilaterally opened their capital markets, mainly to attract direct investments but also in order to benefit from other forms of international capital movements."[10] Along equal lines it may be argued that there is no international legal obligation to introduce particular institutional arrangements with regard to monetary policy. Nevertheless a remarkable synchronization of law and practice can be witnessed with regard to monetary policy. Somewhat pointed central banks can be characterised as being independent and single minded.

The reason for this partially spontaneous harmonization is that capital can move virtually free of restrictions and, given today's technological advances, can be relocated almost instantly. Failing to bring law and practice on macro-economic governance in line with internationally recognised standards and best practice can result in a loss of confidence of globally acting markets in the financial environment of a country at the detriment in the medium-term also of the real economy. Global competition arguably reveals systemic weaknesses also in the legal sphere. It may thus not be surprising that in parallel to the globalization of financial markets also the main contours of monetary policy and the institutions that are charged with its conduct have become less distinct. In fact, a clear monetary policy objective geared towards the combating of inflation has become the dominant feature of central banks. On the institutional side, central bank independence and accountability have

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[8]Amtenbrink/Lastra, Securing Democratic Accountability of Financial Regulatory Agencies – A Theoretical Framework, in: De Mulder (ed.), *Mitigating Risk in the Context of Safety and Security. How Relevant Is a Rational Approach?*, 2008, p. 5 (5).

[9]Trichet, The Role of Central Banks in a Globalized Economy, Speech held on the occasion of the 13th Conference de Montréal, 18 June 2007, p. 1.

[10]Ohler, International Regulation and Supervision of Financial Markets After the Crisis, Working Papers on Global Financial Markets No. 4, March 2009, p. 9.

become two almost globally recognised standards of central bank governance and indeed prerequisite for the credibility of a countries' monetary policy.[11] The existence of this peer pressure to fall in line is verified by the fact that countries lacking a credible monetary policy choose to unilaterally link their currency to that of a country or region with a central bank system featuring such characteristics.[12] The benefits resulting from a managed or fixed exchange rate regime (currency pegging) are thought to outweigh the costs of losing monetary policy as an (ineffective) tool of economic policy.[13]

Facilitating this process of *de jure* synchronization, central bank governance issues, ranging from the legal foundations and accountability to operational issues, are regularly discussed in international fora, such as the Central Bank Governance Forum,[14] the Central Bank Governance Network,[15] and the International Monetary Fund (IMF). This has resulted in standard-setting, such as the 1999 IMF *Code of Good Practices on Transparency in Monetary and Financial Policies*. Rather than to establish a model central bank law the Code defines legal principles and rules of conduct covering responsibilities and objectives of central banks for monetary policy; the openness of the process for formulating and reporting monetary policy decisions, as well as the public availability of information on monetary policy; accountability arrangements for central banks.[16] While this Code is of a non-binding nature, it does not only reflect the major legal characteristics of many central banks today but has also been applied in drawing up new or modernising existing central bank systems, not least as a result of advisory activities of the IMF, such as in the case of the 2004 Central Bank of Iraq Law.[17]

[11] Amtenbrink, The Three Pillars of Central Bank Governance – Towards a Model Central Bank Law or a Code of Good Governance?, in: International Monetary Fund, *Current Developments in Monetary and Financial Law, Vol. 4*, 2005, pp. 101 et seq. (102 et seq.).

[12] Currency board arrangements can for example be observed in a number of countries both inside and outside the EU, including Bulgaria and Bosnia and Herzegovina. Kosovo and Montenegro are examples of countries which use the euro as a parallel currency without any formal monetary agreements with the EU.

[13] In context of the Euro, see Amtenbrink, Bits of Economic and Monetary Union Everywhere, in: Kochenov (ed.), *On Bits of Europe Everywhere. Overseas Possessions of the EU Member States in the Legal-Political Context of European Law*, forthcoming.

[14] A selected group of central bank governors that exchange views on the design and operation of central banks.

[15] Forum bringing together central bank governors to exchange views on issues of central bank governance with the Bank for International Settlements.

[16] IMF, Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles, 1999, available at http://www.imf.org (last accessed 7 May 2010). On the feasibility of a model central bank law (blueprint) see Amtenbrink, The Three Pillars of Central Bank Governance – Towards a Model Central Bank Law or a Code of Good Governance?, in: International Monetary Fund, *Current Developments in Monetary and Financial Law, Vol. 4*, 2005, pp. 101 et seq. (119 et seq.).

[17] Law of 6 March 2004, available at http://www.cbi.iq/ (last accessed 7 May 2010). The IMF was heavily involved in the drawing-up of the new statute.

Central Banks as Guardians of Price Stability

Generally speaking economic policy may be divided into fiscal policy and monetary policy. The latter is generally vested in the central bank of a country which regulates the money supply, as well as the availability (liquidity) and cost of money[18] (interest rates) namely through open market operations (mainly refinancing operations), standing facilities (overnight lending and deposit facilities) and minimum reserve requirements for financial institutions.[19]

In pursuing monetary policy central banks are bound by the objectives which their legal bases set. Such objectives may in principle refer to a whole range of developments including inflation, employment and economic growth. A trend can be observed towards the establishment of a singular monetary objective geared towards price stability. With regard to the latter, the insights into what monetary policy can and more importantly cannot achieve has developed towards the mainstream conviction that the long-term impact of monetary policy on the real economy and namely growth and employment is limited (the so-called neutrality of money),[20] whereas at the same time a low rate of inflation forms the basis for and has a favourable effect on real growth and employment.[21] This is reflected in many modern central bank legal bases which identify price stability as the primary monetary policy objective.

This is not to say however that price stability is in all instances the only or indeed primary monetary objective with which central banks are entrusted. While there has been a clear trend towards giving priority to the combat of inflation,[22] some central bank legal bases still include multiple objectives. In the case of the European Central Bank (ECB), Art. 127(1) TFEU clearly states that the primary objective of the Bank is to maintain price stability. While the European System of Central Banks (ESCB) is also supposed to support the general economic policies in the Union, this is limited by the fact that such activities may not compromise the primary objective of the ECB. In cases where legal bases do introduce multiple objectives in practice some central banks nevertheless orient their monetary policy towards price stability. The *Norges Bank*, the central bank of Norway may serve as an example in this regard. Monetary policy is supposed to be geared towards the

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[18]A broad concept of money is referred to here which does not only include banknotes and coins but also other means of payment, see Mitlid/Vesterlund, Steering interest rates in monetary policy – how does it work, Sveriges Riksbank Economic Review (2001) 1, p. 19.

[19]As this contribution focuses on the monetary policy objective itself, policy instruments are not discussed here.

[20]See e.g. European Central Bank, *The Monetary Policy of the ECB*, 2004, pp. 41–42.

[21]See e.g. Issing, Why Price Stability?, Paper presented at the First ECB Central Banking Conference on 2 and 3 November 2000, available at http://www.ecb.int (last accessed 7 May 2010), with further references to relevant economic literature.

[22]Another example for a major central bank with a single monetary policy objective of price stability is the Bank of Japan. See Art. 2 of the Bank of Japan Act (Act No. 89 of 18 June 1997). The English language version is available at http://www.boj.or.jp/en/ (last accessed 7 May 2010).

stability of the Norwegian krone's national and international value and, at the same time, must underpin fiscal policy by contributing to stable developments in output and employment. The *Norges Bank* has translated this into an operational target geared towards low and stable inflation.[23] Somewhat in contrast to this approach, based on indistinct and multiply statutory monetary objectives, the Federal Reserve System (FED) and namely its Board of Governors and Federal Open Market Committee conducts a monetary policy that promotes the achievement of the statutory objectives of stable prices and maximum employment.[24]

As to the quantification of the monetary policy objective of central banks and thus the degree to which and by whom the primary task of the central bank is demarcated, different arrangements can be observed. Regularly the legal basis of a central bank will not define the monetary objective namely through a quantification of the price stability criterion. Highlighting this point, neither the Statute of the ESCB and of the ECB nor the Federal Reserve Act include any details in this regard.[25] At the same time, the degree to which central banks are free in defining price stability varies. Some legal bases foresee in a procedure for the establishment of policy targets unilaterally by government, such as in the case at the Bank of England,[26] or by means of an agreement between government and the central bank, such as for example at the Reserve Bank of New Zealand.[27] In other instances, most notably the ECB and the FED, it is effectively left to the central bank itself to quantify the monetary policy objective(s). Leaving aside the question whether from the point of view of accountability a central bank should indeed be in charge of setting its own goal(s),[28] there is a notable consistency in the approach by central

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[23]See paragraph 1 of the Regulation on Monetary Policy established by Royal Decree of 29 March 2001 pursuant to section 2, third paragraph, and section 4, second paragraph, of the Act of 24 May 1985 no. 28 on Norges Bank and the Monetary System.

[24]See section 2A(1) of the Federal Reserve Act: "The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Also see the goals of the FED as defined in the Board of Governor's Planning Document 2008–2011, available at http://www.federalreserve.gov (last accessed 7 May 2010). With regard to the approach to monetary policy in practice see Federal Reserve Bank San Francisco, A Primer on Monetary Policy Part I: Goals and Instruments, FRBSF Weekly Letter, Number 94-27, 5 August 1994.

[25]With regard to the ECB see Art. 127(1) TFEU. With regard to the FED see memorandum submitted by the United States Federal Reserve System, in Treasury and Civil Service Committee, The Role of the Bank of England, House of Commons Paper. Session 1993–94; 98-I vol. 2), Report, together with the proceedings of the Committee, HC Session 1993–94 (HMSO, London 1993), app. 20.

[26]See section 12(1) of the Bank of England Act 1998. In practice the Chancellor of the Exchequer sets an inflation target to be pursued by the Bank.

[27]See section 9 Reserve Bank Act 1989 based on which government and the governor of the Bank have to establish a so-called Policy Target Agreement (PTA).

[28]On this issue see Amtenbrink, *The Democratic Accountability of Central Banks*, 1999, chapter 5 I.1.1.

banks to the setting of inflation targets.[29] Thus for example the ECB aims at keeping an inflation rate of below, but close to 2% over the medium term, the most recent inflation target of the Bank of England is set at 2%, the *Norge Bank* targets a consumer price inflation of approximately 2.5% over time, and the latest Policy Target Agreement applicable to the Reserve Bank of New Zealand sets an inflation rate between 1% and 3% on average over the medium term. Despite multiply and non-hierarchical monetary policy objectives even FED officials in the past signalled towards a rate in the region of 3%.[30]

Central Bank Independence and Accountability

Similar to the price stability objective, central bank independence has become an important pillar of central bank governance that has found its way in many central bank legal bases and thus characterises many central bank systems. Based on insights from political economy in the last decades there has been a remarkable trend towards the removal of monetary policy from the political business cycle by positioning central banks outside the *trias politica*.[31]

This trend is closely linked to the attainable aims of monetary policy described in the previous section. Indeed, it has been observed that there is a link between the institutional structure of a central bank and namely its degree of independence and the extent to which it can pursue monetary policy effectively, as "... an independent central bank can give full priority to low levels of inflation, whereas in countries with a more dependent central bank other considerations (notably re-election perspectives of politicians and a low level of unemployment) may interfere with the objective of price stability."[32] Monetary temptations by politicians can stand in the way of an inflation-adverse monetary policy and long-term stability.

[29]In defends of the ECB's approach in this regard this was already noted by Duisenberg, The ECB's quantitative definition of price stability and its comparison with such definitions or inflation targets applied in other large economic areas, Letter to the Chairperson of the Committee on Economic and Monetary Affairs, Mrs. Christa Randzio-Plath, available at http://www.ecb.int (last accessed 7 May 2010).

[30]Greenspan, Opening Remarks to the symposium "Achieving Price Stability", sponsored by the Federal Reserve Bank of Kansas City, 29–31 August 1996, pp. 1–5, available at http://www.kc.frb.org (last accessed 7 May 2010).

[31]For a recent study with further references to economic literature see Crowe/Meade, Central Bank Independence and Transparency: Evolution and Effectiveness, IMF Working Paper WP/08/119.

[32]De Haan/Amtenbrink/Eijffinger, Accountability of Central Banks: Aspects and Quantifications, BNL Quarterly Review, no. 209 – June 1999, pp. 169 et seq. (169–170), with reference to Cuckierman, *Central Bank Strategy, Credibility and Independence*, 1992. For a more recent study, see Alpanda and Honing, Political Monetary Cycles and a de facto Ranking of Central Bank Independence, SSRN Working Paper June 2009, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1032084 (last accessed 7 May 2010).

A monetary policy directed towards low levels of inflation is considered to be more credible. This in return will enhance the effectiveness of the policy conducted by the central bank. Indeed, ample evidence has been provided in economic writing for a negative correlation between central bank independence and inflation and inflation variability.[33] Similar arguments are also applied to financial regulatory and supervisory authorities, as the distance of the latter from government and elected politicians is considered a precondition for the effective conduct of its task, namely banking supervision.[34] These insights have translated into the character of the legal bases of central banks which define the position of the monetary policy authority outside government namely by establishing own legal personality, the freedom to pursue statutorily prescribed objectives and to apply the available instruments more or less insulated from government or parliamentary interventions and by establish the financing of the central bank through own resources.[35] Moreover, this also includes the exclusion or limitation of central bank credit to government.[36]

While in most instances central bank legal bases have the status of an ordinary law (act of parliament), in the case of the European System of Central Banks this feature has been elevated to a quasi-constitutional status, as the TFEU ensures the independence not only of the European Central Bank (ECB), but also of the participating national central banks in the conduct of the tasks assigned to them in the ESCB.[37] Vesting monetary policy and thus, an important part of economic policy outside government and with it the constitutional system of checks and balances applicable thereto has raised concerns about the accountability of central banks for the tasks that have been assigned to them, and namely the pursue of the monetary policy objectives.[38] Indeed, a central bank that continuously pursues a monetary policy which lacks broad political support but also the support of the public at large is likely to be overridden sooner or later.[39] Conversely, a broad public support can help to shield a central bank from political pressure. As a

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[33]See Eijffinger/De Haan, The Political Economy of Central-Bank Independence, Princeton University Special Papers in International Economics, No. 19, May 1996, with further references.

[34]See e.g. Basle Committee of Banking Supervisors, Principles for Effective Banking Supervision, September 1997, List of core principles for effective banking supervision, para. 1.

[35]Different elements refer to the institutional, functional, organizational and financial independence of a central bank.

[36]See e.g. Cottarelli, Limiting Central Bank Credit to the Government. Theory and Practice, IMF Occasional Paper No. 110, December 1993, pp. 3 et seq. In the context of the ESCB see Art. 123–124 TFEU.

[37]Art. 130–131 TFEU and the Protocol on the ESCB and of the ECB annexed to EU Treaty and TFEU; see also Art. 88 of the German Basic Law (*Grundgesetz*) which makes the transfer of monetary policy competences subject to the existence of a ECB that is independent and moreover geared towards maintaining price stability.

[38]See e.g. Gormley/De Haan, The Democratic deficit of the European Central Bank, ELRev. 21 (1996), p. 95; Amtenbrink, *The Democratic Accountability of Central Banks*, 1999, with further references.

[39]De Haan/Amtenbrink/Eijffinger, Accountability of Central Banks: Aspects and Quantifications, BNL Quarterly Review, no. 209, June 1999, pp. 169 et seq. (171).

counterweight to the independent position of central banks, in the last two decades drafters of central bank legislation have become more alert to introduce channels through which the central bank is answerable for its conduct. In general, mechanisms providing those charged with judging the performance of the bank with the necessary means to make an informed assessment and tools to penalize central bank behaviour can be differentiated. In judging the performance of a central bank first and foremost its primary monetary policy objective must be defined as precisely as possible. The trend described in the previous section to identify price stability as an overriding objective in many central bank laws has facilitated the accountability of central banks. At the same time considerable differences exist with regard to the extent to which and by whom the objective is actually quantified. Central bank legal bases regularly impose specific information obligation and thus, transparency requirements. The purpose of these requirements at least in practice is twofold, as they may not only serve the accountability, but also the credibility of the central bank.[40]

At the same time, central bank laws and namely those that provide for a large degree of independence often do not include elaborate provisions linked to penalizing central bank action. This is hardly surprising given the potential trade-off between independence and arrangements such as overriding mechanism allowing for monetary policy decisions to be (temporarily) set aside and the possibility for a performance-based dismissal of central bank officials. To be sure this is not to say that there is no room for such arrangements, as the example of internationally recognized central bank systems, such as the Federal Reserve Bank of New Zealand and the Bank of England, highlight.[41]

Regionalization

An important factor contributing to the unification of the position and tasks of central banks certainly in the European context has been regionalization. Despite several examples of regional cooperation of countries in the economic sphere, such as *inter alia* the North American Free Trade Agreement (NAFTA), the Association of Southeast Asian Nations (ASEAN) and the Common Market of the South (MERCOSUR),[42] undoubtedly the European Union (EU) is the most far-reaching

[40]Dincer/Eichengreen, Central Bank Transparency: Where, Why and With What Effects?, NBER Paper No. 13003, March 2007; De Haan/Amtenbrink/Waller, The Transparency and Credibility of the European Central Bank, JCMS 42 (2004) 4, p. 775, with further references.

[41]The Reserve Bank of New Zealand Act 1989 introduces both an override mechanism and performance-based dismissal of the governor of the Bank. The possibility to override monetary policy decisions can also be found at the Bank of England under the Treasury's reserve powers, see section 19 of the Bank of England Act 1998.

[42]See e.g. Hochreiter/Schmidt-Hebbel/Winckler, Monetary Union: European Lessons, Latin American Prospects, The North American Journal of Economics and Finance 13 (2002) 3, p. 297.

form of regional integration, not least because it also stands for an advanced, albeit far from optimal, system of macroeconomic coordination and monetary policy integration.

Other monetary cooperations are of a geographically and economically limited nature, namely the *Union économique et monétaire ouest-africaine* (UEMOA)[43] with the *Banque centrale des Etats de l'Afrique de l'Ouest (BCEAO)* being entrusted with the conduct of monetary policy of Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Sénégal and Togo, and the *Communauté économique et monétaire de l'Afrique Centrale* (CEMAC)[44] with the *Banque des Etats de l'Afrique centrale* (BEAC) being in charge of monetary policy for Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea and Gabon. Both common currencies, that is the UEMOA Western African CFA franc and the CEMAC Central African CFA franc are convertible through a fixed parity initially with the French franc (now the Euro) based on bilateral agreements.[45]

In contrast, the EU stands for an unprecedented degree not only of legal and economic, but also political and social integration of countries and their citizens. The 1957 Treaty establishing a European Economic Community (EEC Treaty) did not only lay the foundations for the free movement of financial services, the freedom of establishment of financial institutions in all Member States and the free movement of capital,[46] but also already provided the basic rationale for the abolishing of barriers to trade arising from the utilization of each Member State of their own currency.[47] It may thus be little surprising that already in 1970 plans where pursued in the then European Communities to establish a Community system of central banks and to irrevocably fix the exchange rates of the currencies of the Member States.[48] Ironically, these plans for the establishment of a European economic and monetary union in stages became victim of the global economic

[43]Treaty establishing the West African Monetary Union (WAMU) signed on 12 May 1962 (as amended), namely Title V.

[44]Traité du 16 mars 1994 instituant la Communauté Economique et Monétaire de l'Afrique Centrale.

[45]On the efforts of the UEMOA and CEMAC to promote the convergence of economic policies see Strauss-Kahn, Regional Currency Areas: A Few Lessons from the Experiences of the Eurosystem and the CFA Franc Zone, BIS Papers No. 17, supra n. 51, pp. 43–58 (p. 51).

[46]To be sure, free movement of capital was only fully liberalized in primary European law with the coming into effect of the new provisions on capital in the Treaty on the European Union. Prior to that restrictions on movements of capital had already been abolished by secondary Community law, see Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, OJ 1988 L 178/5, and namely the nomenclature in its Annex 1.

[47]*Inter alia* in the shape of exchange rate risks and a lack of price transparency in the internal market.

[48]Report to the Council and Commission on the Realisation by Stages of Economic and Monetary Union in the Community of 8 October 1970, OJ 1970 C 136/1. This document has become better known as the Werner Report.

crisis and the collapse of the first and until the present day only global exchange rate system under the Bretton-Woods Agreement, the so-called Gold Standard,[49] leaving the Member States without any effective coordination of their exchange rates until the establishment of the European Monetary System.

The provisions on Economic and Monetary Union (EMU) introduced by 1993 Treaty on European Union highlight how the role of national central banks can change in the process of the pooling of competencies for monetary policy in a single institutional framework and the replacement of the national currencies by a single common currency. It would be an oversimplification to describe this process as one of centralization of monetary policy. Instead an institutional system has been put in place which, as far as its decision-making structure is concerned, shares some characteristics of federal central bank systems, such as the German Bundesbank and the FED.[50] While monetary policy decisions are no longer taken at the national central banks, their governors – for the time being – all participate in the decision-making in the Governing Council, the decision-making body of the ECB.[51] Due to this involvement of the national central bank governors in the decision-making of the independent ECB, primary Union law extends the independence requirement also to the national central banks of the Member States. Resulting from this, in the run-up to EMU, several central bank laws of the Member States where amended to bring them in line with the provisions of the then EC Treaty (now TFEU) and the Statute of the ESCB and of the ECB.

As a consequence of the pooling of competences in the area of monetary policy the central banks of the euro area Member States were effectively stripped of their primary task and – at least in some instances – also their dominant position in the national system of economic governance.[52] In seeking new areas of activities, not least in order to limit cuts – central banks have taken on new or expanded on existing tasks not linked to those exercised in the framework of the ESCB. In particular with regard to financial markets and namely financial institutions central banks can be seen to fulfil prudential supervisory tasks either on their own or jointly with other national agencies.

[49]See Articles of Agreement of the International Monetary Fund of 2 July 1944, as amended.

[50]It is a well-known fact that namely the Bundesbank-system has been a major source of inspiration for the drafters of the legal framework governing the ESCB and the ECB.

[51]Note that according to Art. 10(2) of the Statute of the ESCB and of the ECB a voting system on a rotation basis is introduced from the time that the number of national central bank governors present in the Governing Council exceeds 15. The introduction of this system has been postponed until the number of national central bank governors exceeds 18. See Decision of the ECB of 18 December 2008 to postpone the start of the rotation system in the Governing Council of the European Central Bank, ECB/2008/29, OJ 2009 L 3/4.

[52]In the case of Germany it is fair to extent this previous position to Europe as a whole, see Marsh, *The Bundesbank. The Bank that Rules Europe*, 1993.

What is more, the establishment of a European regional currency unit has become a model for initiatives in the same direction elsewhere. Thus for example the participating countries in the Gulf Cooperation Council, including Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates have announced plans to launch a single currency.[53]

Global Challenges to Central Banking

In the economic and monetary sphere fiscal and monetary policy authorities find themselves faced with developments which are not only outside their sphere of influence, but at times also difficult to anticipate. While the global financial crisis may be considered the prime example in this regard, the same also holds true under normal conditions in the global economy.

The Globalization of Monetary Policy

The challenges which central banks face in the light of globalization and also regionalization are not only of an institutional nature, but also concern the monetary policy tasks they perform. More concrete, central banks are faced with economic developments outside their sphere of influence. It has been highlighted that globalization increases uncertainty for monetary policy and evidence has been provided to the effect that central banks have become less effective in influencing national liquidity conditions.[54] Whether and to what extent central banks should pursue a monetary policy that is more geared towards taking into account possible spill-over effects as a result of global financial markets is arguably not primarily a legal question in the sense that this does not require an adjustment of the legal basis of a central bank, but rather of the monetary policy strategy pursued by the central bank. Given their independent position, this is primarily for the central bank itself to decide upon.

However, does globalization have an influence on the central bank in pursuing its primary/main monetary policy objective in the first place? With the opening of markets global developments namely linked to the trade in goods and services have an impact on the development of prices. Both positive and negative effects can be

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[53]See Sturm and Siegfried, Regional Monetary Integration in the Member States of the Gulf Cooperation Council, ECB Occasional Paper Series No. 31, June 2005; see also Malliaris, The Global Monetary System: Its Weaknesses and the Role of the IMF, the EU and NAFTA, North American Journal of Economics and Finance 13 (2002), pp. 72 et seq.

[54]See e.g. the study by Belke/Rees, The Importance of Global Shocks for National Policy Makers. Rising Challenges for Central Banks, Ruhr Economic Papers No. 135, September 2009, who identify global liquidity as an important factor.

linked to this globalization of inflation.[55] On the one hand, globalization is considered to have had a positive effect on inflation in industrial countries by inducing downward pressure on prices *inter alia* through the opening of labour markets, better allocation of (financial) resources and increased competition.[56] However, highlighting the complexity of the effects of the processes involved, globalization may also induce upward pressure on prices as demand namely for energy and raw materials in emerging economies has grown notably. Whether and to what extent a positive correlation between globalization and inflation exists in the long-run remains subject of debates. Summarizing the scepticism raised against the globalization-of-inflation argument Ball argues: "In my view, there is little reason to think that globalization has influenced inflation significantly. "Modest" and "limited" probably overstate the effects."[57]

Trichet has observed that "Whatever the influences being exerted in the context of globalisation, the basic principle which allows the anchoring of monetary policy remains: in the long run, inflation is a monetary phenomenon. As a consequence, globalisation does not affect the central role and overriding responsibility of central banks to preserve price stability"[58] However, even if this is true, it should not be mistaken for an argument that globalization cannot have an impact on the policy stands of a central bank. While in the absence of exchange rate arrangements central banks continue to decide themselves on the rate of inflation of their currency,[59] in determining their approach to monetary policy and thus their strategy monetary policy authorities do need to take into account the "global factors [that] drive inflation" and thus the external factors that put pressure on prices.[60] What is more, the aftermath of the global financial crisis highlights that external and

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[55]Generally see International Monetary Fund, Globalization and Inflation, World Economic Outlook, April 2006.

[56]See e.g. Rogoff, Impact of Globalization on Monetary Policy, Paper prepared for the symposium sponsored by the Federal Reserve Bank of Kansas City, August 2006, available at http://www.kc.frb.org/PUBLICAT/SYMPOS/2006/pdf/rogoff.paper.0829.pdf (last accessed 7 May 2010), pp. 6 et seq; but see Trichet, The Role of Central Banks in a Globalized Economy, Speech held on the occasion of the 13th Conference de Montréal, 18 June 2007, p. 4, who also refers to other contributing factors not directly linked to globalization, such as budgetary discipline and the anti-inflationary approach to monetary policy.

[57]Ball, Has Globalization Changed Inflation, NBER Working Paper No. 12687, November 2006, p. 1

[58]Trichet, The Role of Central Banks in a Globalized Economy, Speech held on the occasion of the 13th Conference de Montréal, 18 June 2007.

[59]A point made by Kohn, The Effects of Globalization on Inflation and Their Implications for Monetary Policy, Speech held at the Federal Reserve Bank of Boston's 51st Economic Conference, 16 June 2006, available at http://www.federalreserve.gov (accessed 7 May 2010).

[60]Brackets added. Rogoff, Impact of Globalization on Monetary Policy, Paper prepared for the symposium sponsored by the Federal Reserve Bank of Kansas City, August 2006, available at http://www.kc.frb.org/PUBLICAT/SYMPOS/2006/pdf/rogoff.paper.0829.pdf (last accessed 7 May 2010), p. 8; Ball, Has Globalization Changed Inflation, NBER Working Paper No. 12687, November 2006, p. 3, argues that financial openness as defined by the ratio of foreign assets and liabilities have an impact on interest rates and asset prices.

asymmetric shocks can compel central banks to act in the face of a narrowly defined monetary policy objective.

In fulfilling their tasks in a globalized economy the margin of error for central banks are smaller than has previously been the case. Much more so than by any formal mechanisms of accountability vis-à-vis government and/or parliament, central banks are judged by their actions. Kohn observes in this context that "… integrated financial markets can exert powerful feedback, which may be less forgiving of any perceived policy error".[61] The author highlights this point with reference to the FED: "For example, if financial market participants thought that the FOMC was not dedicated to maintaining long-run price stability- a notion that I can assure you is not correct- they would be less willing to hold dollar-denominated assets, and the resulting decline in the dollar would tend to add to inflationary pressures."[62]

While there are currently no concrete plans in this direction, the global financial openness and the risks of spill-over and domino effects linked thereto does raises the question whether new, reinforced forms of transnational economic and monetary governance are required.[63] This has accumulated in calls for the establishment of a global monetary authority.[64] Such far-reaching proposals may be a long way off, to say the least. Yet the above mentioned trend towards the regional pooling of monetary policy could, if continued, facilitate the rebirth of a global exchange rate mechanism to facilitate stability.

By pooling monetary policy as in the case of the ESCB and the ECB, an additional challenge arise if the transfer of competences with regard to monetary policy is not accompanied by a transfer of equal competences for the conduct of a common economic policy. In the EU economic policies remain to a large extent a domain of the Member States. This poses special challenges for the ECB in formulating and implementing monetary policy in the euro area. From the start it could be observed that economic developments of the euro area Member States were anything but homogenous, raising the question whether the EU or at least the euro area actually constitutes an optimal currency area.[65] While the success of

[61]Kohn, The Effects of Globalization on Inflation and Their Implications for Monetary Policy, Speech held at the Federal Reserve Bank of Boston's 51st Economic Conference, 16 June 2006, available at http://www.federalreserve.gov (last accessed 7 May 2010).

[62]Kohn, The Effects of Globalization on Inflation and Their Implications for Monetary Policy, Speech held at the Federal Reserve Bank of Boston's 51st Economic Conference, 16 June 2006, available at http://www.federalreserve.gov (last accessed 7 May 2010).

[63]See e.g. the study by Belke/Rees, The Importance of Global Shocks for National Policy Makers. Rising Challenges for Central Banks, Ruhr Economic Papers No. 135, September 2009.

[64]See e.g. Garten, Global authority can fill financial vacuum, Financial Times Online edition, published on 25 September 2008, available at http://www.ft.com (last accessed 7 May 2010); Calvo, Lender of last resort: Put it on the agenda!, VoxEU.org Policy Note, 23 March 2009, available at http://www.voxeu.org (last accessed 7 May 2010).

[65]Issing, One size fits all! A single monetary policy for the Euro Area, Speech held at the International Research Forum, 20 May 2005; Amtenbrink, Economic, Monetary and Social Policy, in: McDonnell/Kapteyn/Mortelmans/Timmermans (eds.), *The Law of the European Union and the*

monetary policy in such an asymmetric system of economic governance depends not in the least on strong legal mechanisms to ensure fiscal discipline of the participating Member States, the near *de facto* insolvency of the euro area Member State Greece highlights the severe shortcomings of the present system of economic coordination in the EU and the danger this poses for a unified monetary policy.

The Global Economic Crisis

The global financial crisis has highlighted the consequences and knock-on effects that the collapse of large financial institutions can have not only on the financial system but also on the real economy. While central banks arguably played a role both in the making of and dealing with this crisis of global proportions, it is arguably the former which has attracted the attention of legislators and policy makers the most, resulting in the re-assessment of the role of central banks.[66]

In analysing the causes of the global financial crisis the European Commission mandated 2009 Larosière Report identifies several causes including *inter alia*: the illusion that permanent and sustainable high level of growth are sustainable; fundamental failures in the evaluation of risk and the role that Credit Rating Agencies play with regard to the assessment of credit risk; a failure of corporate governance; a failure of the regulatory and supervisory system as well as of the crisis management.[67] In this context also the role of central bank has been criticised for having contributed to 'benign macroeconomic conditions' through low interest rates which, combined with low inflation rates have resulted in a rapid growth of the volume of credit. Namely the role of the Fed has been questioned for its omission to tighten its monetary policy stands, thereby meeting excess liquidity namely in the shape of rapidly rising asset prices. In the view of experts this has contributed to the

European Communities, (4th ed.) 2008, pp. 881 et seq. (966), on early signs of diverging economic situations in the euro area.

[66]With regard to the role of central banks in dealing with the crisis that is not explored in this contribution, see e.g. Bank for International Settlements Committee on the Global Financial System, Central bank operations in response to the financial turmoil, Report submitted by a Study Group established by the Committee, July 2008, available at http://www.bis.org (last accessed 7 May 2010); Papademos, How to deal with the global financial crisis and promote the economy's recovery and sustained growth, Speech held at the 7th European Business Summit organised by the European Business Forum, 26 March 2009, available at http://www.ecb.int (last accessed 7 May 2010); Roth, Challenges for Central Banks during the Current Global Crisis, address at the occasion of the Sixth Annual NBP-SNB Joint Seminar on "Challenges for Central Banks during the Current Global Crisis", 15 June 2009, available at http://www.snb.ch/n/mmr/reference/sem_2009_06_14_speech/source (last accessed 7 May 2010).

[67]The High-Level Group on Financial Supervision in the EU (Larosière Report), chaired by J. de Larosière, 25 February 2009, p. 7 et seq. To be sure, the policy recommendations made in this report are not all limited to the EU.

housing bubble that is linked to the subprime mortgage crisis.[68] The credibility of central banks has suffered as a result of this. Indeed, central banks have been diagnosed with a "doctrinal blindness",[69] and the rationale of the focus in many central bank systems on price stability is questioned. The objectives of central banks are considered to be insufficiently geared towards detecting and addressing system risks.[70] To be sure, the primarily economic debate on the contribution of central banks to the global financial crisis is far from conclusive. Nevertheless it seems appropriate to raise the issue of possible legal consequences for the future position and tasks of central banks and namely, whether and to what extent the monetary policy objective should be geared towards or include aims other than price stability, and to what extent central banks should play a more active role in (macro-) prudential supervision.[71]

Central banks may find themselves faced with demands for the inclusion in their legal bases of new or the extension of existing objectives and tasks linked to prudential supervision. As the separation of the monetary policy from the financial regulatory and supervisory tasks are believed to have contributed to a one-sided focus on inflation,[72] a more prominent role for central banks in monitoring systemic risks is suggested. Thus for example the Larosière Report recommends that central banks "... should receive an explicit formal mandate to assess high-level macro-financial risks to the system and to issue warnings where required."[73] From a legal

[68]The High-Level Group on Financial Supervision in the EU (Larosière Report), chaired by J. de Larosière, 25 February 2009, p. 7; for a brief assessment of the contribution of the U.S. subprime mortgages market to the financial crisis see Ohler, International Regulation and Supervision of Financial Markets after the Crisis, Working Papers on Global Financial Markets No. 4, March 2009, pp. 5 et seq; see also the remarks by the Governor of the Bank of Japan: Shirakawa, Revisiting the Philosophy behind Central Bank Policy, Speech at the Economic Club of New York, 22 April 2010, available at http://www.boj.or.jp/en (last accessed 24 April 2010), p. 5, who openly wonders: "For me, the key question, which applies to many central banks including both the Bank of Japan and the Federal Reserve, is that, why we, as central banks, maintained interest rates at such a low level, in spite of the uneasiness we felt at that time toward the bubble-like symptoms."

[69]Roberts, The Failure of the Guardians: Central Banking Reform and the Financial Crisis, Suffolk University Law School Legal Studies Research Paper Series, Research Paper 09-54, 21 December 2009, p. 17, who observes that "Central bank independence was not justified as a technique for protecting systemic stability", but rather, "an anti-inflation regime".

[70]See e.g. Frisell/Roszbach/Spagnolo, Governing the Governors: A Clinical Study of Central Banks, Sveriges Riksbank Research Paper Series No. 54, March 2008, p. 8; Shirakawa, Revisiting the Philosophy behind Central Bank Policy, Speech at the Economic Club of New York, 22 April 2010, available at http://www.boj.or.jp/en (last accessed 24 April 2010), pp. 7–8.

[71]On the terminology see Clement, The term "macro prudential": origins and evolution, BIS Quarterly Review, March 2010, p. 59.

[72]Shirakawa, Revisiting the Philosophy behind Central Bank Policy, Speech at the Economic Club of New York, 22 April 2010, available at http://www.boj.or.jp/en (last accessed 7 May 2010), pp. 5–6.

[73]The High-Level Group on Financial Supervision in the EU (Larosière Report), chaired by J. de Larosière, 25 February 2009, p. 44.

point of view it takes little to include financial stability as another central bank (monetary) objective in particular since many central bank laws in principle already recognise a role of the central bank in monitoring developments in this regard.[74] However, objections are the feasibility of assigning a system stability objective to central banks and the effects which the taking on of supervisory tasks may have on the independence of monetary policy (operations).

Including a system stability objective in the legal basis of a central bank raises the question exactly what the position of such an additional mandate should be next to the existing primary objective currently found in many central bank laws. Should it be given priority, placed on an equal footing with price stability or come as a secondary objective? As has been observed above multiple central bank objectives may not only be problematic from the point of view of accountability, but come at the expanse of the effective conduct of any price stability objective. The latter of course assumes the existence of a trade-off between price stability and a system stability objective. This is however far from undisputed. Calling for the inclusion of an explicit system stability objective also suggested that the price stability objective is not sufficient in this regard. However, Issing has argued that "... if the central bank employs a medium term horizon for the definition of price stability and implies a strategy encompassing a stability-oriented, forward-looking approach, financial imbalances will implicitly obtain the attention they deserve. This is true even if financial stability is not considered a general objective of the central bank and monetary policy aims at maintaining the objective of price stability. [...] In most cases price stability would foster financial stability".[75] Supporting this view past research suggests that "... price level instability also contributed to financial instability historically".[76] Yet other factors also contribute to financial stability.[77] In fact it has been acknowledged that "... financial imbalances can build up even in an environment of stable prices"[78] Moreover, even if a system stability objective is provided for, given the nature of the subject-matter, this could hardly amount to a precise or even quantified objective. This is highlighted by the

[74]See e.g. Art. 127(5) TFEU and Art. 3.3. of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank, OJ 2008 C 115/230, according to which the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.

[75]Brackets added and footnote omitted; Issing, Monetary and Financial Stability: Is there a Trade-off?, Speech presented at the conference on "Monetary Stability, Financial Stability and the Business Cycle", 28–29 March 2003, Bank for International Settlements, available at http://www.ecb.int (last accessed 7 May 2010). Issing does acknowledge the possibility of short-term conflicts "in rare circumstances".

[76]Bodo/Wheelock, Price Stability and Financial Stability: The Historical Record, Federal reserve Bank of St. Louis Review, September/October 1998, pp. 41 et seq. (60).

[77]See Trichet, Laudatio for Hans Tietmeyer, Speech held on 26 March 2010, available at http://www.ecb.int (last accessed 7 May 2010).

[78]Issing, Monetary and Financial Stability: Is there a Trade-off?, Speech presented at the conference on "Monetary Stability, Financial Stability and the Business Cycle", 28–29 March 2003, Bank for International Settlements, available at http://www.ecb.int (last accessed 7 May 2010).

objectives in the legal bases of existing regulatory and supervisory agencies outside central banks, where general references to preserving the stability of the financial system or to maintaining market stability and at times even multiple objectives linked to financial stability can be found.[79] Judging a central bank's performance based on such broad objectives is difficult beyond generally noting the absence of financial instability and/or insolvent financial institutions.[80]

What is more, calls for a greater role in monitoring system stability imply that central banks can actually effectively detect systemic risks and act upon them with the instruments currently at their disposal. In defence of placing these tasks with the central bank it can be argued that "... synergies can be achieved by combining information gained from prudential supervision and from the conduct of monetary policy, the overall responsibility of the central bank for the stability of the system as a whole and the independence position of central banks and technical expertise existing therein, are all arguments in favour of vesting this task in the central bank."[81] Applying a similar economy-of-scale argument the Larosière Report emphasizes that "... the role of central banks which are by essence well placed to observe the first signs of vulnerability of a bank is of crucial importance."[82] As concerns the ability of a central bank to fulfill such a task, Issing notes that "The uncertainty related to the identification of an asset price bubble is not fundamentally different from the uncertainty surrounding other variables, in which the central bank bases its policy decisions."[83] At the same time, against the background of the housing bubble both Issing, as well as Posen question the ability of central banks to effectively intervene once systemic risks have actually been detected. Posen observes that the tightening of monetary policy in response to such developments "in no way substitutes for directly dealing with the underlying financial problems" while at the same time producing costs for the real economy.[84] Yet, even if

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[79]Exemplary in this regard are the five statutory objectives laid down for the UK Financial Services Authority in the Financial Service and Markets Act 2000.

[80]With regard to the usefulness of such broad objectives for accountability purposes, see e.g. Hüpkes/Quintyn/Taylor, The Accountability of Financial Sector Supervisors: Principles and Practice, IMF Working Paper WP/05/51, 2005.

[81]Amtenbrink, Economic, Monetary and Social Policy, in: McDonnell/Kapteyn/Mortelmans/Timmermans (eds.), *The Law of the European Union and the European Communities*, (4th ed.) 2008, pp. 881 et seq. (972), with further references.

[82]The High-Level Group on Financial Supervision in the EU (Larosière Report), chaired by J. de Larosière, 25 February 2009, pp. 7 et seq.

[83]Issing, Monetary and Financial Stability: Is there a Trade-off?, Speech presented at the conference on "Monetary Stability, Financial Stability and the Business Cycle", 28–29 March 2003, Bank for International Settlements, available at http://www.ecb.int (last accessed 7 May 2010).

[84]Posen, Why Central Banks Should Not Burst Bubbles, Peterson Institute for International Economics Working Paper Series WP 06/1, January 2006, p. 11, who argues that "... the connection between monetary conditions and the rise of bubbles is rather tenuous, and by raising interest rates a central bank is unlikely to achieve what is needed — i.e., persuading investors that the bubble is ill-founded and/or that they will not find some greater fool to sell to in time."; see also Issing, Monetary and Financial Stability: Is there a Trade-off?, Speech presented at the conference

monetary policy may not provide the necessary instruments to intervene, this is not to say that central banks are *per se* unsuitable for the job. In this regard much depends on the legal arrangements governing micro-prudential supervision and, to the extent that this task is placed (partially) outside the central bank, on the extent to which the central bank cooperates with the competent financial regulatory and (other) supervisory authorities. In case of a separation of tasks the role of the central bank may be primarily that of monitoring and informing/advising the competent agencies on systemic risks and how to address them.

Assigning prudential supervisory tasks to a central bank may not be entirely unproblematic. Indeed, monetary policy and prudential supervision are somewhat uneasy bedfellows.[85] While it may be argued that as a lender of last resort central banks should in principle be in a perfect position to monitor financial stability and to judge whether financial institutions are actual insolvent or simply in need of liquidity, Di Noia and Di Giorgio with reference to work by Goodhart and Schoenmaker conclude that: "... this argument does not hold, in the sense that the 'revealed preferences' of monetary authorities have been to 'rescue banks running into difficulties so long as there appeared to be any risk of a systemic knock-on effect'".[86]

Assigning multiple tasks to the central bank can give rise to perverse incentives on parts of the central bank that may be tempted to (ab-) use monetary policy as a tool to fulfil its role as supervisor, resulting in biased policy decisions.[87] Supporting this view, empirical evidence points to a positive correlation between the placement of all banking supervisory tasks at the central banks and the rate and volatility of inflation in countries.[88] However, one should be careful not to conclude from this

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on "Monetary Stability, Financial Stability and the Business Cycle", 28–29 March 2003, Bank for International Settlements, available at http://www.ecb.int (last accessed 7 May 2010), who raises doubts as to the ability of central banks to detect such bubbles in real time.

[85] See generally on this issue Schoenmaker, Institutional Separation Between Supervisory and Monetary Agencies, FMG Special papers No. 52, Financial Markets Group Research Centre, 1992; Di Noia/Di Giorgio, Should Banking Supervision and Monetary Policy Tasks be Given to Different Institutions?, International Finance 3 (1999) 2, pp. 361 et seq. (368 et seq.); ECB, The Role of Central Banks in Prudential Supervision, Position Paper, 2001, available at http://www.ecb.int (last accessed 7 May 2010); in the European context see also Smits, *The European Central Bank: Institutional Aspects*, 1997, pp. 310–327; Andenas/Hadjiemmanuel, Banking Supervision, The Internal Market and European Monetary Union, in: Andenas et al. (eds.), *European Economic and Monetary Union: the Institutional Framework*, 1997, pp. 371 et seq. (386–394); an instructive overview of the arguments is provided in a position paper by the European Central Bank: The Role of Central Banks, 2001, in particular p. 3–7.

[86] Di Noia/Di Giorgio, Should Banking Supervision and Monetary Policy Tasks be Given to Different Institutions?, International Finance 3 (1999) 2, pp. 361 et seq. (368), with reference to Goodhart/Schoenmaker, Should the functions of monetary policy and banking supervision be separated?, Oxf. Econ. Pap. 47 (1995) 4, p. 539.

[87] Tuya/Zamalloa, Issues on Placing Banking Supervision in the Central Bank, in: Balino/Cottarelli (eds.), *Frameworks for Monetary Stability*, 1994, pp. 663 et seq. (679).

[88] Di Noia/Di Giorgio, Should Banking Supervision and Monetary Policy Tasks be Given to Different Institutions?, International Finance 3 (1999) 2, pp. 361 et seq. (376).

that central banks should not at all be involved in prudential supervision. In fact what is missing in debates on this topic is a clear differentiation between macro- and micro-prudential supervisory tasks and thus, the task of ensuring the stability of the financial system as a whole and the task of ensuring the safety of the banking system (banking supervision). Indeed, the concerns about possible conflicts of interests may be primarily linked to the latter function. It is at least not evident why reinforced rules on the monitoring of financial stability and, where necessary, a formal obligation to informing and advice competent regulatory and supervisory agencies would be a major problem in this regard. Understood in such away, macro-prudential supervision does not have to be at odds with the independent position of a central bank or its primary monetary policy objective. Anything beyond such a role however can create conflicts of interest and, in the case of a bad handling of a crisis moreover result in reputational damage with effects also for monetary policy. The vesting of extensive supervisory or even regulatory powers would also result in a further accumulation of powers in what is already a major independent policy maker – in many instances – effectively remote from the constitutional system of checks and balances.

The integrated financial systems call for a global assessment of their stability. Yet, any one central bank system arguably cannot make this assessment without proper information. Thus, cooperation between central banks takes place through an array of formal and informal international networks.[89] This cooperation takes place *inter alia* through the Financial Stability Board,[90] the before mentioned Central Bank Governance Forum[91] and the Central Bank Governance Network.[92] This also extents to global financial markets and to micro-prudential supervision. The coordination and exchange of information is just as important as the establishment of global standards and best practice. Once again the EU can serve as an example for system providing for a such coordination, albeit being far from ideal in this regard.

The role of the ECB in prudential supervision as described in the TFEU and the Protocol on the ESCB and on the ECB is essentially limited to that of an advisor to the Council, the European Commission and the competent authorities of the Member States relating to the prudential supervision of credit institutions and to the stability of the financial system as a whole.[93] Financial market supervision is

[89]On central banks as network institutions, see Marcusson, The transnational governance network of central bankers, in: Djelic/Sahlin-Anderson (eds.), *Transnational Governance. Institutional Dynamics of Regulation*, 2006, pp. 180 et seq. (191 et seq.).

[90]Successor to the Financial Stability Forum. It brings together namely representatives from national governments, central banks and supervisory agencies.

[91]Selected group of central bank governors that exchange views on the design and operation of central banks.

[92]Forum bringing together central bank governors to exchange views on issues of central bank governance with the Bank for International Settlements.

[93]Smits, *The European Central Bank: Institutional Aspects*, 1997, pp. 339–343, 353. In this context Smits criticises the fact that the Protocol on certain provisions relating to the United

effectively in the hands of the national competent authorities of the Member States which in some, but certainly not all instances are the national central bank. Under the current EU Lamfalussy framework no centralization, but rather a coordination of supervisory tasks, namely through the Level 2 and Level 3 committees takes place. The difficulties of coordinating supervisory efforts in such a decentralised system have been extensively discussed in the relevant literature.[94]

The absence of a prudential supervision task of the ECB may be historically explained by the reluctance of national governments (and indeed their central banks) to vest also supervisory tasks upon a supranational independent monetary policy authority, resulting not only in an accumulation of power, but also a further loss of tasks for national central banks to perform.[95] This may also explain why the enabling clause of ex Art. 105(6) EC which allowed for the transfer to the ECB of specific tasks concerning policies relating to the supervision of credit institutions and other financial firms excluding insurance undertakings has never been activated. In fact the provision has been left unchanged by the Treaty of Lisbon which does not vest any new supervisory powers in the ECB.[96]

In the wake of the global financial crisis the European Commission has revisited the existing Union framework and made concrete proposals to reinforce financial supervision.[97] The several legislative proposals address both macro- as well as micro-prudential supervision of the financial markets. From the outset it is noteworthy that none of these proposals aim at outright placing macro- or micro-prudential supervision at the ECB. Instead, on the micro-prudential side the European Commission proposes the establishment of a European System of Financial Supervisors (ESFS), consisting of a network of national financial supervisors working in cooperation with three new regulatory agencies, including a European Banking Authority, a European Insurance and Occupational Pensions Authority and a European Securities and Markets Authority.[98] While placed outside the ECB,

Kingdom and the Protocol on certain provisions relating to Denmark for excluding this role of the ECB. This may be particularly problematic in the case of the United Kingdom as the most important European financial capital.

[94]E.g. Lastra, *Central Banking and Banking Regulation*, 1996, with further references.

[95]See Smits, *The European Central Bank: Institutional Aspects*, 1997, pp. 334–338.

[96]Now Art. 127(6) TFEU.

[97]European Commission adopts legislative proposals to strengthen financial supervision in the EU, Press release of 23 September 2009, IP/09/1347.

[98]Proposal for a regulation of the European Parliament and of the Council establishing a European Banking Authority, COM(2009) 501 final; Proposal for a regulation of the European Parliament and of the Council establishing a European Insurance and Occupational Pensions Authority, COM(2009) 502 final; Proposal for a regulation of the European Parliament and of the Council establishing a European Securities and Markets Authority, COM(2009) 503 final; see also Proposal for a Directive of the European Parliament and of the Council Amending Directives 1998/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC, and 2009/65/EC in respect of the powers of the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, COM(2009) 576 final.

close institutional links primarily with the future European Banking Authority are foreseen through the participation, albeit in a non-voting capacity, of an ECB representative.

As far as macro-prudential supervision is concerned the European Commission has proposed the establishment of a European System Risk Board (ESRB).[99] The ESRB would be established as an EU regulatory agency and thus be formally placed outside the ECB. Nevertheless, the envisaged composition of the main decision-making body highlights the close link to the ECB, the national central banks and the national supervisory authorities all of which would make up the majority of the members of the General Board of the ESRB.[100] Moreover, it is planned to situate the secretariat of the ESRB at the seat of the ECB, so that synergies can emerge between these two bodies. The ESRB would be responsible for the macro-prudential oversight of the EU financial system "... in order to prevent or mitigate systemic risks within the financial system, so as to avoid episodes of widespread financial distress, contribute to a smooth functioning of the Internal Market and ensure a sustainable contribution of the financial sector to economic growth."[101] For this purpose the ESRB would not only be charged with identifying and prioritizing such risks, but in the case of the emergence of significant risks to issue warnings and even recommendations for remedial action.[102] Addressee of these warnings and recommendations could be the EU as a whole, the proposed European regulatory agencies, Member States or national supervisory authorities.[103] Moreover, it is foreseen that the ESRB cooperates with international institutions such as the IMF. All in all, namely the initiative to establish an ESRB highlights the recognition in the EU of the need for more effective mechanisms to prevent the emergence of a global financial crisis of the proportions which can currently be witnessed.

Concluding Remarks

Ever since their emergence as sole issuer of currency, the role of central banks has constantly evolved accommodating both for the development of (international) trade and the understanding of the fundamentals of the economy. With the emergence of regional economic cooperation namely in the second half of the twentieth

[99]Proposal for a Regulation of the European Parliament and of the Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board, COM(2009) 499 final; Proposal for a Council Decision entrusting the European Central Bank with specific tasks concerning the functioning of the European Systemic Risk Board, COM(2009) 500 final.

[100]Ibid., Art. 4(1), (2) and Art. 6.

[101]Ibid., Art. 3(1).

[102]Ibid., Art. 15–18.

[103]Ibid., Art. 16(2).

century and the gradual opening of domestic markets which increasingly has turned into a global phenomenon, more than ever before in their history central banks find themselves influenced by global trends and developments both in their institutional set-up and their main monetary policy task.

More so than national regulators and policy makers the institutional characteristics and main monetary policy objectives are decided by global financial markets on whose trust central banks rely. This is facilitated by the drafting by international standard setting organisations, such as the IMF, of guidelines and codes of best practice. The lattor has resulted in a de facto synchronization of the main institutional features and monetary tasks. Yet, in particular the *unisono* focus on price stability has been criticised in the aftermath of the global financial crisis for having contributed to a general failure by central banks to detect system risks.

In pursuing monetary policy in a global environment central banks may in fact be much less independent in the conduct of monetary policy than their statutory legal bases and – at times – regulators and policy makers suggest. This is not only true but certainly also true in times of global financial crisis. Next to government interventions, central banks have played a major role in adding liquidity to the financial market and by guaranteeing (government) debts.[104] Central banks could be seen relaxing their monetary policies stands, whereby in some instances conventional monetary policy reached its outer limits. Roberts predicts that as a result of the role of central banks in the financial crisis "... it seems probable that skepticism about technocratic governance and about the trustworthiness of markets will encourage the reassertion of political influence in policy domains that were, in the heyday of liberalization, the preserve of technocrat-guardians."[105] Translated to the position of central banks this suggests that public and eventually political pressure may grow to revisit the position of monetary policy authorities outside government. However, it is unclear in exactly what ways the involvement of elected politicians and government officials under the direct influence of the former would be an improvement upon the current situation or would have prevented the crisis. As far as monetary policy is concerned, in the absence of any evidence suggesting

[104]For an early overview of the role of central banks in dealing with the global financial crisis, see Bank for International Settlements Committee on the Global Financial System, Central bank operations in response to the financial turmoil, Report submitted by a Study Group established by the Committee, July 2008, available at http://www.bis.org (last accessed 7 May 2010); Papademos, How to deal with the global financial crisis and promote the economy's recovery and sustained growth, Speech held at the 7th European Business Summit organised by the European Business Forum, 26 March 2009, available at http://www.ecb.int (last accessed 7 May 2010); Roth, Challenges for Central Banks during the Current Global Crisis, address at the occasion of the Sixth Annual NBP-SNB Joint Seminar on "Challenges for Central Banks during the Current Global Crisis", 15 June 2009, available at http://www.snb.ch/n/mmr/reference/sem_2009_06_14_speech/source (last accessed 7 May 2010).

[105]Roberts, The Failure of the Guardians: Central Banking Reform and the Financial Crisis, Suffolk University Law School Legal Studies Research Paper Series, Research Paper 09-54, 21 December 2009, p. 25.

that the theoretical and empirical foundation of the current institutional arrangements, i.e. the negative correlation between central bank independence and inflation and inflation variability, is obsolete changing the institutional position of central banks would simply increase political influence without any major benefits.

All the same time, the financial crisis should be seen as an opportunity to seriously re-evaluate the role of central banks as monetary policy authorities in a global economy. In doing so it should be taken into consideration that, a simple proliferation of central bank tasks does not necessarily make their role any more effective or indeed straightforward.

An International Normative Framework for Sovereign Wealth Funds?

Ludwig Gramlich

Introduction

In September 2007, a senior IMF economist wrote in a short paper about the rise of sovereign wealth funds (SWFs):

> Sovereign wealth funds are a fairly new name for something that's been around for quite a while: assets held by governments in another country's currency. All countries have foreign exchange reserves (these days, they're typically in dollars, euros, or yen). When a country, by running a current account surplus, accumulates more reserves than it feels it needs for immediate purposes, it can create a sovereign fund to manage those "extra" resources.[1]

Some 2 years later, in a working paper of the IMF Monetary and Capital Markets Department a somewhat different answer to the question "what is a sovereign wealth fund?" was given by several authors (of course claiming that their views did not necessarily represent official IMF policy):

> SWFs are defined as a special purpose investment fund or arrangement, owned by the general government.[2] Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer financial assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.[3]

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[1]Johnson, Finance & Development 44 (2007) 3, available at http://www.imf.org/external/pubs/ft/fandd/2007/09/straight.htm.

[2]Referring to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, Appendix I, see http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 7 et seq.; for more on that document see below, pp. 394 et seq., 624 et seq.

[3]Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 5.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_3, © Springer-Verlag Berlin Heidelberg 2011

A third quotation, taken from a speech delivered by a member of the board of Schweizerische Nationalbank, reads:

> Broadly defined, SWFs are government-owned investment corporations. For the most part, they invest their funds in foreign currency assets. SWFs are usually managed separately from central bank reserves. Unlike other publicly owned pools of capital, such as social security funds or public pension funds, SWFs have no explicit liabilities.[4]

Looking at some major topics of current discussions about that "growing global force",[5] headlines are pointing – to quote but a few – to "its implications upon the global monetary regime and economic order",[6] the impact of SWFs "on global financial markets" or "international financial stability",[7] and whether those funds might be a "menace" even to leading industrial countries such as the USA so that some "control mechanisms" should be established to meet "challenges" arising from what are seen as rather ambiguous policies of certain SWFs.[8] So it seems to be an open question (at least for German authors) whether a proper solution should be based upon the maxim *pecunia non olet* or if states should take protective measures against SWFs ("*Müssen wir uns vor Staatsfonds schützen*?").[9]

Since even a swift glance at the global landscape shows a wide variety of actors, activities and policies (of SWFs as well as of the home or "sponsor" states where these funds are domiciled and of the host – or recipient – countries where they are investing), it seems evident that the current situation might be improved by shaping an appropriate international framework to enhance the economic benefits for all parties concerned. But this statement only refers to the general need for reaching a basic consensus upon some fundamental aspects of the structure, objectives and activities of SWFs. Thus, this study primarily aims to point out a few essential elements of an adequate international normative framework, drawing first upon some basic issues, then (B), then upon common features of several national laws dealing with SWFs and, moreover, upon current actions or proposals from various

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[4]Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, p. 2; similarly Aizenmann/Glick, *Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance*, 2008, p. 4.

[5]See Butt/Shivdasani/Stendevad/Wyman, Sovereign wealth funds: a growing global force in corporate finance, Journal of Applied Corporate Finance 20 (2008), pp. 73 et seq.

[6]See Suzuki, *The launch of China's sovereign wealth fund: long-term implications upon the global monetary regime*, Mizuho Research Paper 16, 2008.

[7]See Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008; Gomes, *The impact of sovereign wealth funds on international financial stability*, Bank of Canada, Discussion Paper 14, 2008.

[8]See Kern, *Control mechanisms for sovereign wealth funds in selected countries*, CESifo DICE Report (2008) 4, pp. 41 et seq.; Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, p. 1, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf.

[9]See Schäfer/Voland, Staatsfonds: die Kontrolle ausländischer Investitionen auf dem Prüfstand des Verfassungs-, Europa- und Welthandelsrechts. Pecunia non olet?, EWS 19 (2008), pp. 166 et seq.; Klodt, Müssen wir uns vor Staatsfonds schützen?, Wirtschaftsdienst 88 (2008), pp. 175 et seq.

(international) institutions and (C) and, on the basis of that analysis, to give a short evaluation of the main (draft) rules. Before reaching some tentative conclusions, it also seems appropriate to look at how SWFs acted during the recent global financial crisis to find out whether those funds (or their owners) used this chance to change their investment strategies and policies to achieve ends other than (macro)economic, namely genuinely political, ones.

Basic Issues

As the citations might have shown, a common (legal) definition of SWFs does not exist. So, it seems first necessary to take a closer look at the core elements of those entities to describe them as precisely as possible and at the same time to draw clear distinctions between them and similar financial institutions.[10]

Searching for a Precise Legal Definition of SWFs

A SWF may be broadly defined – according to a recent European Central Bank (ECB) paper[11] – as a "public investment agency" which manages "part of the foreign assets of governments". Three elements might thus be common to such funds: they are "state-owned", they are "not subject to a committed stream of permanent payments" and they are "managed separately from official foreign exchange reserves".[12]

Fund

The first element seems rather vague. "Fund(s)" or "arrangement(s)"[13] are not clear terms in a legal sense, the former being solely directed at certain financial assets (without any clarification as to ownership and institutional structure), whereas the

[10]See also pp. 336 et seq.

[11]See Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, p. 6; see also Weller, Ausländische Staatsfonds zwischen Fusionskontrolle, Außenwirtschaftsrecht und Grundfreiheiten, ZIP 2008, p. 858, and Mezzacapo, *The so-called "Sovereign Wealth Funds": regulatory issues, financial stability and prudential supervision*, 2009, pp. 4 et seq.

[12]A somewhat different definition is found in Appendix I to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, p. 27, which refer to (1) ownership, (2) investments (at least partially in foreign financial assets) and (3) (macroeconomic) purposes and (financial) objectives.

[13]As Appendix I to the Santiago Principles explains (see p. 27, fn. 41), the use of the word "*arrangements*" as an alternative to "*funds*" allows for a flexible interpretation of the legal arrangement through which the assets can be invested.

latter focuses upon contractual relationships between two or more parties, but does not clarify any aspects of the (legal) form and content, e.g. whether these arrangements will establish public corporations or private companies as funds' owners (or managers). Looking at existing SWFs,[14] there are separate legal entities as well as autonomous units within a central bank[15] or within a government ministry, normally the ministry of finance.

Wealth (Fund)

The term "wealth" used for describing those funds (or arrangements) is hardly less ambiguous. Often or even regularly, SWFs were set up after (oil or other) commodity price booms[16]; more recently, in the case of China, the cause was evidently a general large increase in export receipts.[17] Following such large accumulations of (international) financial assets, policy makers discuss a number of objectives deemed to be optimal for their country. A key question in this context will be to determine whether there is an "adequate" and "ample" level of international (i.e. foreign currency) reserves to be used for traditional balance of payments or (other) monetary policy purposes, if necessary.[18] Although "SWF" is an all-encompassing term, even (financial) operations of state-owned enterprises in a traditional sense or government-employee pension funds may be excluded from this concept only if either the main objectives, strategies and fields of operation (in respect of traditional

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[14]Background information on International Working Group of Sovereign Wealth Funds (IWG) member countries' SWFs can be found in Appendix III to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 31 et seq.; another rich source of information is the Web site of the Sovereign Wealth Fund Institute, http://www.swfinstitute.org/; for a brief outline, see also IWG Secretariat, *Sovereign Wealth Funds – Current Operational and Institutional Practices*, 15 Sept. 2008, p. 5.

[15]See, e.g., the Exchange Fund of Hong Kong Monetary Authority , http://www.swfinstitute.org/fund/hongkong.php; Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, p. 9; Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 8 or the case of Saudi Arabian Monetary Authority, http://www.swfinstitute.org/fund/saudi.php.

[16]Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 6.

[17]See Suzuki, *The launch of China's sovereign wealth fund: long-term implications upon the global monetary regime*, Mizuho Research Paper 16, 2008; Heep, Chinas neuer Staatsfond: Organisation, Finanzierung und Investitionsstrategie der China Investment Corporation, Asien 108 (2008), pp. 51 et seq.

[18]See Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, pp. 6 et seq.; Rozanov, Long-Term Consequences of the Financial Crisis for SWFs, in: Hoguet/Nugée/Rozanov (eds.), *Vision: Sovereign Wealth Funds. Emerging from the Financial Crisis*, 2009, p. 14; the power to invest "extra" resources is not mentioned by Hindelang, Direktinvestitionen und die Europäische Kapitalverkehrsfreiheit im Drittstaatenverhältnis, JZ 2009, p. 829.

state-owned enterprises[19]) or the existence of explicit liabilities and a continuous stream of payments (in the case of pension funds) is taken into account.[20] Nonetheless, SWFs cover a group of heterogeneous funds that have existed for many years and most of them were created to meet macroeconomic purposes.

Sovereign (Fund)

In a narrow sense, "sovereign" would be closely related to or even identical with the terms "state" and "government". Thus, the IWG and IMF definitions look at SWFs as created and/or owned by "general" government"[21]; a similar expression used later by IMF authors is "public ownership".[22] An additional criterion taken into account might be the objectives which should be met by SWFs. These may be multiple in nature (e.g. savings, fiscal stabilization, development) but will always be determined by public interests.[23] Each SWF's policy objectives and activities should be consistent with a country's overall macroeconomic framework because the fund's assets, and the returns it generates, will have important impacts on a country's public finances, monetary conditions, balance of payments and the overall balance sheet, and further, it may also affect public sector wealth in general and influence private sector behaviour. Therefore, it seems critical for each SWF that mechanisms of appropriate coordination with fiscal and monetary authorities of its home state be established.[24]

But regardless of the specific relationship with the government and its particular governance structure,[25] at least the operational management of a SWF should be conducted on an independent basis to minimize political influence or interference that could hinder the fund in achieving its general (policy) objectives. Operational

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[19]See Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, p. 4; Golding/Bassil, *Australian Regulation of Investments by Sovereign Wealth Funds and State Owned Enterprises*, 2008, p. 2.

[20]In this sense see Appendix I to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, no. 3.

[21]Appendix I to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, nos. 2, 4.

[22]Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 5.

[23]For more details see Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, pp. 9 et seq.

[24]See *Foreign Asset Accumulation by Authorities in Emerging Markets*, ECB Monthly Bulletin, Jan. 2009, pp. 76 et seq.

[25]See Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, pp. 13 et seq.; for considerations to hire external asset managers ibid., p. 18; IWG Secretariat, *Sovereign Wealth Funds – Current Operational and Institutional Practices*, 15 Sept. 2008, p. 17; Kern, *Staatsfonds – Staatliche Auslandsinvestitionen im Aufwind*, DBResearch, 18 Dec. 2007, p. 5.

independence could – following the example of central bank statutes[26] – be embedded in the rules and procedures for appointment of the president or (other) members of the governing body. There should be at least a solid legal foundation for an internal institutional structure shaping a clear principal–agent relationship as well as distinguishing decision making from oversight functions.

Specific Nature of SWFs

Most SWFs share some other characteristics, in particular the pursuit of long-term investment strategies and a willingness to take risk and substantial exposure to foreign investments. Whether a change in the global financial structure will have a significant impact on international financial stability might in fact depend upon the motives underlying the investment decisions of SWFs.[27] On the one hand, those funds may contribute to a widening of the long-term investor base for risky assets (such as stocks, corporate bonds, emerging markets assets, private equity and real estate). In this regard, they could exert a stabilizing effect on financial markets, and moreover, enable a more efficient sharing and diversification of risk at the global level. But on the other hand, when SWF activities are driven by political considerations, those motives might lead to excessive risk-taking and a distortion of asset prices, so certain investment patterns could negatively impact market integrity. Political leaders seem to be becoming increasingly anxious because the rapid rise of SWFs and their increasing visibility as large investors in mature markets challenge some long-held assumptions about how the global economy works.[28] So, their investment decisions run the risk of triggering defensive reactions in developed (recipient) countries. This process could lead to financial protectionism which would clearly be to the detriment of global economic welfare.[29]

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[26]See IWG Secretariat, *Sovereign Wealth Funds – Current Operational and Institutional Practices*, 15 Sept. 2008, pp. 8 et seq.

[27]See Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, pp. 10 et seq.

[28]See Weller, Ausländische Staatsfonds zwischen Fusionskontrolle, Außenwirtschaftsrecht und Grundfreiheiten, ZIP 2008, p. 858; O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, Sept. 2008, p. 19; Kaufmann, *Investoren als Invasoren*, 2009, pp. 23 et seq.; Sauvant/Maschek/McAllister, *Foreign Direct Investment by Emerging Market Multinational Enterprises, the Impact of the Financial Crisis and Recession and Challenges Ahead*, OECD, Dec. 2009, p. 7.

[29]See Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, p. 13; Moran, *Foreign Acquisitions and National Security: What are genuine threats? What are implausible worries?*, Dec. 2009, http://www.oecd.org/dataoecd/31/23/44231376.pdf.

Development and Objectives of SWFs

Some Historical Remarks

SWFs are not new phenomena. With its Caisse des Dépots et Consignations, France set up such an entity nearly 200 years ago, in 1816.[30] The Kuwait Investment Authority (KIA) was established in 1953,[31] the Abu Dhabi Investment Authority (ADIA)[32] and the Alaska Permanent Fund (Corporation)[33] were set up in 1976 and the two Singapore SWFs Temasek Holdings[34] and GIC[35] were set up in 1974 and 1981, respectively. It seems that SWFs have been created essentially in two waves, the first one occurring between 1973 and 1983 (Brunei Investment Authority[36]), the second one starting with the setting up of Norway's Government Pension Fund

[30]Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, p. 2, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, p. 4; Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 314; see also Altorfer-Ong, Ein Schweizer Staatsfonds aus dem 18. Jahrhundert, Neue Zürcher Zeitung no. 67, 20 March 2008.

[31]See Al Sa'ad, *Overview on the Kuwait Investment Authority and Issues Related to Sovereign Wealth Funds*, 9 April 2008, www.kia.gov.kw/En/About_KIA/Overview_of_KIA/Documents/FINA_SPCH_LUXEMBORG_APR_9_092.pdf); see also Appendix III to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 38 et seq.; http://www.swfinstitute.org/fund/-kuwait.php; Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, p. 6.

[32]See http://www.swfinstitute.org/fund/adia.php; see also Appendix III to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 48 et seq.

[33]See http://www.swfinstitute.org/fund/alaska.php; see also Appendix III to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, p. 49; Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 12.

[34]Temasek Holdings Pte Ltd; see http://www.swfinstitute.org/fund/temasek.php; see also Appendix III to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 45 et seq.; O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, Sept. 2008, p. 7.

[35]Government of Singapore Investment Corporation Pte Ltd; see. http://www.swfinstitu-te.org/fund/gic.php; see also Appendix III to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 44 et seq.; Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, p. 9; Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 12.

[36]See http://www.swfinstitute.org/fund/brunei.php.

Global[37] – in 1996.[38] So far, SWFs have been initiated predominantly in the Middle East and in Asia. These regions account for about 75% of the assets of the more important funds.[39] Nonetheless, SWFs holding a significant part of those assets are located in developed countries, namely in the USA,[40] Australia,[41] Ireland,[42] South Korea,[43] New Zealand[44] and Norway.[45]

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[37]See http://www.swfinstitute.org/fund/norway.php; also Appendix III to the “Santiago Principles” of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 41 et seq.; Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, p. 10; Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 12.

[38]Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, p. 4.

[39]Qatar Investment Authority, Investment Corporation of Dubai (which is separate from the now famous Dubai World, see http://www.dubaiworld.ae), Emirates Investment Authority; for more details, see Setser/Ziemba, *GCC Sovereign Funds – Reversal of Fortune*, CFR Working Paper Jan. 2009, pp. 9 et seq.

[40]Alaska Permanent Fund Corporation, http://www.swfinstitute.org/fund/alaska.php, New Mexico State Investment Office Trust, http://www.swfinstitute.org/fund/newmexico.php, Alabama Trust Fund, http://www.swfinstitute.org/fund/alabama.php, Permanent Wyoming Mineral Trust Fund, http://www.swfinstitute.org/fund/wyoming.php.

[41]Australian Government Future Fund; see http://www.swfinstitute.org/fund/australia.php (5 Jan. 2010).

[42]National Pensions Reserve Fund; see http://www.swfinstitute.org/fund/ireland.php (5 Jan. 2010); see also Appendix III to the “Santiago Principles” of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 36 et seq.

[43]Korea Investment Corporation; see http://www.swfinstitute.org/fund/korea.php (Jan. 5, 2010); see also Appendix III to the “Santiago Principles” of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 37 et seq.

[44]New Zealand Superannuation Fund; see http://www.swfinstitute.org/fund/newzealand.php; see also Appendix III to the “Santiago Principles” of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, pp. 40 et seq.; Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 12, fn. 41.

[45]See Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, p. 4; also Reiche, Norwegen: Staatsfonds und Ethik, Blätter für deutsche und internationale Politik (2008) 11, pp. 111 et seq.

Different Objectives

In line with the sources of their funds, SWFs can broadly be distinguished in terms of their objectives in five types:

> (i) reserve investment corporations, that aim to enhance returns on reserves; (ii) pension-reserve funds; (iii) fiscal stabilization funds; (iv) fiscal savings funds; and (v) development funds that use returns to invest for development purposes.[46]

Pension funds accumulate assets now to offset the projected higher liability related to sustaining pensions and social welfare in the future. Depending upon the macroeconomic framework, these assets will often be invested abroad, so that they can be disinvested and used for imports when the domestic population comes of age.[47]

Fiscal stabilization and fiscal savings funds are often related to commodity-related wealth. Savings funds generally focus on intergenerational equity and transfers aiming at benefiting the current and future generations as equally as possible, e.g. by setting up an endowment-type fund that converts a finite (extractive) asset into an infinite string of financial cash flows. This objective is of essential importance for governments of countries that have limited natural resources or face great uncertainty as to the future size of commodity streams.[48] Commodity-extracting economies may also be able to stabilize the fiscal impact of fluctuating commodity prices via fiscal stabilization funds designed to smooth boom/bust cycles.[49] Saving assets abroad can assist in mitigating the so-called Dutch disease[50] and alleviating related (negative) macroeconomic consequences.[51]

In fact, objectives for establishing SWFs may be either multiple or changing over time (or both), especially in the case of natural-resource-exporting countries.[52]

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[46]Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 9; Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, pp. 4, 11.

[47]Prominent examples of this type might be Australia, Ireland, New Zealand and Norway, but at least similar objectives were laid down for the Chilean Pension Reserve and Social and Economic Stabilization Fund, http://www.swfinstitute.org/fund/chile.php, and the Chinese National Social Security Fund, http://www.swfinstitute.org/fund/nssf.php.

[48]See Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, pp. 9, 11; Kaufmann, *Investoren als Invasoren*, 2009, p. 21.

[49]Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 10; Kaufmann, *Investoren als Invasoren*, 2009, p. 25.

[50]See Neary, Deindustrialization and Dutch disease, http://www.cepr.org/Pubs/bulletin/004/Neary.htm.

[51]See Aizenmann/Glick, *Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance*, 2008, p. 3.

[52]See Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 10.

Initially, a stabilization fund might be set up to smooth fiscal revenue or sterilize foreign currency inflows. As the assets in the fund continue to grow beyond the level needed for the purposes of stabilization, e.g. when prices are elevated over a prolonged period, home country authorities of a SWF may revisit its original objectives and redesign the structure of such a fund to broaden or modify the objective. Russia is a good example for that.[53]

Finally, many SWFs are either commodity-based or non-commodity-based. The first group earns money directly either through receipts from commodity exports or through taxes charged by the government upon resource-related activities.[54] The second one is financed by a transfer of excessive foreign exchange reserves accumulated by the central bank and resulting from high current account surpluses or inflexible exchange rate regimes. A prominent case for this group is China, which set up the China Investment Corporation (CIC) in 2007.[55]

Structure and Activities

As many SWFs do not publish (much) relevant data on their size, but also owing to different definitions of these entities, there is a wide range of uncertainty with respect to the number of SWFs and the assets held by them. Today, there are at least more than 50 such funds in more than 40 countries.[56] Most of them seem to have unique characteristics so "there is no such thing as an average SWF".[57] Some funds are rather new, some very old, some are very big, some very small, some are passive investors, whereas others are active ones. But SWFs have grown tremendously during the last 20 years, and are expected to continue to grow strongly in the years

[53] National Welfare Fund, see http://www.swfinstitute.org/fund/russia.php; Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, p. 9; see also Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 10, fn. 14, and p. 12, fn. 38.

[54] See Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 315; Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, p. 4; Aizenmann/Glick, *Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance*, 2008, p. 2.

[55] See http://www.swfinstitute.org/fund/cic.php; see also Appendix III to the "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, p. 36; Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 315; Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, pp. 6 et seq.

[56] See Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, pp. 5, 12.

[57] Economist, 18 Sept. 2008; see also O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, Sept. 2008, p. 5; Rozanov, Long-Term Consequences of the Financial Crisis for SWFs, in Hoguet/Nugée/Rozanov (eds.), *Vision: Sovereign Wealth Funds. Emerging from the Financial Crisis*, 2009, p. 15.

to come. Although the financial market crisis and its negative effects on export prices and export expectations of many countries might have slowed down the rapidity of growth, assets held and managed by SWFs will probably exceed official currency reserves until the middle of the next decade.[58]

There is no uniform organizational structure of SWFs, although a clear separation of responsibilities and authority could be established by a well-defined governance framework. Some examples described below may show a broad variety, so it will hardly be possible to find a core of common features.

ADIA, e.g., is led by a board of directors, this "supreme body" having absolute control over the fund's offices and the discharge of its business. The board comprises a chairman, a managing director and eight other members, all of whom are senior government officials appointed by ruler's decree.[59]

The highest decision-making body of Korea Investment Corporation (KIC) is the Steering Committee, currently composed of nine members: six professionals from the private sector appointed by the Korean president, serving 2-year terms, the CEO of KIC and, finally, the minister of strategy and finance and the governor of the Bank of Korea. The chairman of this committee is elected from among the private sector members. The KIC Board of Directors comprises five persons: CEO, auditor, chief investment officer, chief operating officer, and chief risk and compliance office.[60]

Temasek Holdings was incorporated under the Singapore Companies Act as an investment holding company in 1974, its sole shareholder being the Singapore government through the minister of finance. Most of the members of the Temasek Board, which is responsible for investment, divestment and other operational decisions, stem from the private sector. The board appoints and removes its CEO subject to the concurrence of the president of Singapore because of its constitutional role to protect past reserves accumulated prior to the current government's term of office in certain "designated organizations", one of them being Temasek. The president's concurrence is also required if the government (as a shareholder) is going to appoint, renew or remove board members, but neither the head of state nor the government is involved in operational decisions of the company.

CIC is an investment institution established as a wholly state owned company under the Company Law of the People's Republic of China and is headquartered in Beijing. CIC's comprehensive three-tiered corporate governance structure includes a board of directors, a board of supervisors and an executive committee. Although it operates with independence and its investment decisions should be based on purely economic aspects of each deal, CIC remains accountable to the State Council of the People's Republic of China.

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[58]See Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, pp. 5 et seq.; Aizenmann/Glick, *Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance*, 2008, p. 1.

[59]See http://www.adia.ae/ADIA_AE_structure.asp?navLoc=structure.

[60]http://kic.go.kr/en/?mid=in0201.

The New Zealand Superannuation Fund was established by an act of parliament in 2001 which also set up a crown entity to manage and administer the fund. Any substantive changes require legislative amendments.

The managing separate entity is overseen by a board ("guardians"[61]), the members of which – from five to seven – are appointed by the governor-general on the recommendation of the minister of finance based upon nominations from an independent committee on the basis of their experience, training and expertise in the management of financial investments. The minister must also consult representatives of political parties in parliament. The guardians appoint the CEO, who in turn recruits staff to assist the board in developing and implementing investment policy. Although accountable to government, the guardians operate at arm's length from government. The minister of finance may give directions to them regarding the government's expectations as to the fund's performance, but must not give any direction "that is inconsistent with the duty to invest the fund on a prudent and commercial basis". Any ministerial direction must be tabled in parliament.

It is left to the guardians to decide how best to fulfil their mandate, i.e.

> to invest the Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with
> (a) best-practice portfolio management,
> (b) maximising return without undue risk to the Fund as a whole, and
> (c) avoiding prejudice to New Zealand's reputation as a responsible member of the world community.[62]

Funding and Spending Rules

The policies and rules for a SWF's funding, withdrawal and spending operations should be clear and consistent with the (main) objectives and purposes of each fund, not least concerning the transfer of monies between a SWF and its owner(s).[63] Referring to savings types of SWFs, in particular, *Das et al*. propose providing such funds with a clear investment mandate without the need to keep liquidity for unpredictable calls by the government, but to allow it to invest in government bonds if that seems fit and is consistent with the macroeconomic framework.[64] They also point[65] to some relatively hard rules for the deposit and withdrawal of resources in the case of Russia, where oil and gas proceeds exceeding the amount

[61]Crown Entities Act 2004, sec. 86.

[62]New Zealand Superannuation and Retirement Income Act 2001, secs. 64 and 58.

[63]Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 11.

[64]Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 12.

[65]Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 12, fn. 18.

to be transferred to the budget is channelled to the reserve fund until it reaches 10% of GDP. Australia's Future Fund prohibits any withdrawals until 2020. Norway's Government Pension Fund Global is even an integrated part of government finances: the accumulation of capital in this fund consists of the net cash flow from all petroleum revenues plus the return on the fund's assets, whereas the outflow from the fund is destined to finance the non-oil budget deficit. More generally, the fiscal guideline for the state budget seems to require a balance (over time) between the structural oil-adjusted budget deficit and the expected real return on the capital of the pension fund.

Some SWFs directly pay a dividend to the citizens or to the (home state) government, for example Alaska's Permanent Fund. Others, however, allow great discretion for the government. In the case of GIC, which manages funds on behalf of its clients, the Singapore government (represented by the minister of finance) and the monetary authority, the constitution not only designates this private company as a "fifth schedule" entity, thus coming (like Temasek) under the purview of the president of Singapore in various key areas, but also provides that part of the investment income on Singapore's reserves can be taken into the government's budget to support spending thereupon, and, specifically, the government is allowed to spend up to 50% of the "net investment income" derived from "past reserves".

Investment Strategies and Policies

Until now, and as long as there are no (published) normative instructions for specific investment policies (and these are followed strictly by fund managers), many SWFs have not disclosed their assets and investment strategies in a sufficiently transparent manner.[66] Until a few years ago, the majority of SWFs seemed to have acted rather conservatively, concentrating their assets in areas which would secure fixed income.[67] On the other hand, larger investments in publicly listed equities or in alternative asset classes were not widespread. Only since the middle of the last decade have SWFs begun to diversify their assets, most probably pushed by swiftly rising fund volumes.[68]

Although a clear picture of SWFs' activities might thus hardly be sketched, these entities are, in fact, a very heterogeneous group of investors since their (strategic)

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[66]For determinants of investment policy, see Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, pp. 14 et seq.; see also Aizenmann/Glick, *Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance*, 2008, p. 12.

[67]*Foreign Asset Accumulation by Authorities in Emerging Markets*, ECB Monthly Bulletin, Jan. 2009, p. 84.

[68]Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, p. 7; IWG Secretariat, *Sovereign Wealth Funds – Current Operational and Institutional Practices*, 15 Sept. 2008, p. 15.

asset allocation schemes reflect rather different objectives. Their activities are thus often similar to those of private asset managers, in particular mutual funds.[69] A recent survey distinguishes between two groups of investment behaviour of SWFs: the first one is still primarily attached to relatively traditional asset allocation (focusing on highly rated government securities), whereas the second one uses different asset classes ranging from equity to real estate,[70] infrastructure and commodities. Most cross-border equity investments of SWFs still seem to be portfolio investments driven by longer-term return motivations and concentrated upon smaller equity stakes (of less than 10% or even 5%) to diversify risks.[71]

But obviously, in recent years, the interest of SWFs to invest in larger equity stakes that would enable them to exert control of target companies (or even the countries where those companies are domiciled) has grown. Although foreign direct investment by SWFs is still very low compared with foreign direct investment by private strategic investors,[72] by private equity funds and by hedge funds, this phenomenon and its increase has provoked fears that sovereign funds will no longer restrict their policies to reaching (macro)economic goals, but will extend them to primarily political ones. It seems rather evident that foreign direct investment by SWFs is largely concentrated in some sectors and regions, in respect of the home countries of these funds (United Arab Emirates and Singapore) as well as the states where the target companies are located (mostly developed Western countries, including Germany, Denmark, the UK and the USA).[73] When it comes to "sensitive" industries, however, not all SWFs are acting in the same way. There is a broad distinction between the activities of SWFs of smaller and militarily insignificant countries such as the United Arab Emirates, Kuwait and even Saudi Arabia (although there might be other concerns about Persian Gulf countries[74]) and entities of powerful countries such as China and Russia, both of which have long-term global strategic interests.[75]

[69]See Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, p. 12.

[70]See *Weltweiter Wettlauf um Agrarland in Drittweltländern*, NZZ no. 134, 13–14 June 2009. For a case study (relating to Norway's Government Pension Fund) see Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, pp. 21 et seq.

[71]Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, p. 8.

[72]See Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, pp. 12 et seq.

[73]See Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, p. 9; Aizenmann/Glick, *Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance*, 2008, pp. 19 et seq.; Kaufmann, *Investoren als Invasoren*, 2009, pp. 52 et seq.

[74]See Behrendt, *Der neue Staatskapitalismus*, Financial Times Deutschland, 8 Dec. 2009.

[75]See O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, Sept. 2008, p. 3; see also *Chinas Staatsfonds hat wohl mehr als nur finanzielle Absichten*, NZZ no. 225, 29 Sept. 2009.

If changing patterns of investments by SWFs are leading to new or enhanced vetting mechanisms in countries worried about (at least) some of those foreign investors and companies to be acquired by them, responses by SWFs or their home countries might follow and, thus, matters might become even worse, ending up in a spiral of deliberalization of international capital transactions and finally in welfare losses for all parties. Thus, cooperation between SWFs, their home states and (potential) target or recipient countries of investments should be a top priority of international politics, and international financial institutions should join these three groups of actors to achieve a solid and adequate normative framework integrated into a broader global economic legal order.

SWFs and Other Funds Engaged in International Financial Activities

In April 2009, the European Commission presented a proposal on a draft directive on alternative investment fund managers (AIFMs)[76] as part of an ambitious programme to extend appropriate regulation and oversight to all actors and activities that embed significant risks because the current regulatory environment would not adequately reflect the cross-border nature especially of macroprudential (systemic) risks to the stability and integrity of European financial markets. This legislation aims at introducing harmonized requirements for entities engaged in the management and administration of alternative investment funds (AIFs), defined as all funds that are not regulated under the (new) Undertakings for Collective Investment in Transferable Securities (UCITS) Directive[77] and including hedge funds and private equity funds, as well as real estate, commodity, infrastructure and other types of institutional funds. The draft focuses upon the scope and definitions, operating conditions and initial authorization, treatment of investors, disclosure to regulators, specific requirements for leveraged AIFs, rights and obligations for AIFMs and, finally, supervisory cooperation, information sharing and mediation.

As the proposed directive should also make an important contribution to the reinforcement of a global approach to supervision of AIFs (and, in the end, also of other funds, although SWFs were neither addressed in this proposal nor in the UCITS Directive), it deals with third-country aspects too. On the one hand, it would permit AIFMs to market AIFs located in third-country domiciles subject to strict controls on the performance of key functions by service providers in those jurisdictions. On the other hand, the draft directive allows AIFMs established in a third country to market their funds in the EU provided that the regulatory framework and supervisory arrangements in that third country are equivalent to those of the proposed legal act,

[76]COM(2009) 207 final of 29 April 2009.

[77]Directive 2009/65/EC of 13 July 2009, OJ 2009 L 302, pp. 32 et seq.

and EU operators will enjoy comparable access to that third-country market (Arts. 35 et seq.).

The parallel provision of the directive on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (Art. 9) which addresses relations with foreign countries provides for the application of the relevant rules already laid down in Art. 15 of the Markets in Financial Instruments Directive (MiFiD) of 2004.[78] UCITS are undertakings[79] with the sole object of collective investment in "transferable securities" (especially shares and debt securities, Art. 2 [n]) or in some other liquid assets operating on the principle of risk-spreading and with "units" (including shares of other UCITS, Art. 1 [3]) which are, at the request of holders, repurchased or redeemed out of those undertakings' assets (Art. 1 [2]). To secure for EU "management companies"[80] effective market access comparable to that granted by the EU to firms from the respective third country as well as national treatment affording the same opportunities as are available to domestic companies, the European Commission is bound to start negotiations to remedy this situation. But that body may also decide that member states' authorities must limit or suspend operations by third-country undertakings for a while. Of course, any measures taken according to Art. 15 must comply with the EU's obligations under any international agreements governing the taking up or pursuit of the business of management companies.

The UCITS Directive deals, in particular, with issues of authorization, obligations regarding different forms of undertakings, their investment and information policies as well as general obligations on UCITS. Further provisions concern mergers, cross-border transactions and authorities responsible for authorization and supervision.

In its communication on SWFs, the European Commission intended to address the issues posed by those funds as a "specific category of cross-border investments".[81] But the sole feature distinguishing them from other investment vehicles is that they are state-funded[82] whereas the activities and operations of all these entities seem very similar.[83] So it is rather evident that "SWF portfolios include a wider

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[78]Directive 2004/39/EC of 21 April 2004, OJ 2004 L 145, pp. 1 et seq.

[79]These may be constituted in accordance with contract law (as common funds managed by management companies), trust law (as unit trusts), or statute (as investment companies), Art. 1 (3) of the UCITS Directive.

[80]Defined in Art. 2 (a) of the UCITS Directive as "*company, the regular business of which is the management of UCITS in the form of common funds or of investment companies*".

[81]A common European approach to Sovereign Wealth Funds, COM(2008) 115 final, 27 Feb. 2008, p. 2.

[82]In the same sense European Parliament resolution of 9 July 2008 on SWFs, OJ 2009 C 294E, pp. 41 et seq.: "*The ownership structure of the SWFs places them outside the scope of EU financial market regulation*"; Kern, *Staatsfonds – Staatliche Auslandsinvestitionen im Aufwind*, DBResearch, 18 Dec. 2007, p. 13.

[83]See Mezzacapo, *The so-called "Sovereign Wealth Funds": regulatory issues, financial stability and prudential supervision*, 2009, pp. 10 et seq.; Fraktion BÜNDNIS 90/DIE GRÜNEN, Deutscher Bundestag, Drucksache 16/9612, 18 June 2008, pp. 3 et seq.; O'Brien, *Barriers to*

range of financial assets, including fixed-income securities, but also equities, real estate and alternative investments".[84]

Concepts for a Normative Framework at International Level

Global Institutions

G7 finance ministers invited in October 2007 major multilateral international organizations, such as the IMF and the OECD, to launch a reflection on the role of the SWFs and on the mechanisms to address the challenges they pose.[85]

International Monetary Fund

Recognizing the growing importance of SWFs and the role of the IMF in monitoring the health of its member countries' economies and the global financial system, the IMF's ministerial guidance body – the International Monetary and Financial Committee (IMFC)[86] – initiated a dialogue with countries to arrive at a voluntary set of best practices in the management of SWFs. In response thereto, the IMF's work on these funds was at a number of fronts. So, a round table of sovereign asset and reserve managers was organized in November 2007, attended by high-level delegates from central banks, ministries of finance, and SWFs from 28 countries, which included a preliminary discussion with key SWFs.[87] Moreover, the IMF has been coordinating its work on SWFs with the OECD, also liaising closely with the European Commission, the World Bank, and others. The OECD was ready to take the lead on issues related to investment policies and regulations in recipient countries. In March 2008, the IMF's Executive Board discussed a paper that set out the

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Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds, Sept. 2008, p. 10; Rozanov, Long-Term Consequences of the Financial Crisis for SWFs, in Hoguet/Nugée/Rozanov (eds.), *Vision: Sovereign Wealth Funds. Emerging from the Financial Crisis*, 2009, p. 18; Kern, *Staatsfonds – Staatliche Auslandsinvestitionen im Aufwind*, DBResearch, 18 Dec. 2007, p. 10.

[84] A common European approach to Sovereign Wealth Funds, COM(2008) 115 final, 27 Feb. 2008, p. 3.

[85] See Mezzacapo, *The so-called "Sovereign Wealth Funds": regulatory issues, financial stability and prudential supervision*, 2009, p. 66.

[86] IMF Articles of Agreement, art-XII (1); A Guide to Committees, Groups, and Clubs, http://www.imf.org/external/np/exr/facts/groups.htm#IC.

[87] See IMF press notices http://www.imf.org/external/np/sec/pr/2007/pr07267.htm; http://www.imf.org/external/np/sec/pr/2009/pr0944.htm.

IMF's work programme regarding SWFs[88] aimed at the preparation of a set of best practices for managing SWFs in order to present a draft at the IMF's annual meeting in October 2008.

At that meeting,[89] the IMFC welcomed

> the development of the Santiago Principles by the International Working Group of Sovereign Wealth Funds (SWFs). The Principles represent a collaborative effort by SWFs from across advanced, emerging, and developing country economies to set out a comprehensive framework, providing a clearer understanding of the operations of SWFs. Their adoption on a voluntary basis signals strong commitment to the Principles and their implementation should further enhance the stabilizing role played by SWFs in the financial markets, and help maintain the free flow of cross-border investment,

and it also "stress[ed] the importance of clear and non-discriminatory policies by recipient countries toward SWF investments".

Since then, however, the topic seems to have been shelved. The communiqués published by the IMFC in the spring and autumn of 2009[90] do not mention SWFs (issues) at all.

Organization for Economic Cooperation and Development

The G8 Summit Declaration of summer 2007[91] reinforced the commitment of world leaders to "freedom of investment", stating that

> we remain committed to minimize any national restrictions on foreign investment. Such restrictions should apply to very limited cases which primarily concern national security. The general principles to be followed in such cases are non-discrimination, transparency and predictability. In any case, restrictive measures should not exceed the necessary scope, intensity and duration. Applicable treaties relating to investment remain unaffected. We encourage the OECD to continue its work on these issues, especially by identifying best practices and by further developing general principles. We will work with the OECD and other fora to develop further our common understanding of transparency principles for market-driven cross border investment of both private and state-owned enterprises.

This Paris-based institution consisting mostly of (Western) developed countries then adopted a declaration (in June 2008) to express the commitment of 33 states to preserve and expand an open international investment "environment" for SWFs. This "guidance to recipient countries" should, together with the GAPP (i.e. the "Santiago Principles"), "provide the international community with a robust framework for

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[88]Allen/Caruana, *Sovereign Wealth Funds – A Work Agenda*, http://www.imf.org/external/np/pp/eng/2008/022908.pdf; IMF press notice, http://www.imf.org/external/np/sec/pn/2008/pn0841.htm.

[89]For earlier work, see IMF Annual Report 2008, pp. 31 and 35.

[90]Press notices: http://www.imf.org/external/np/cm/2009/042509.htm, http://www.imf.org/external/np/sec/pr/2009/pr09347.htm

[91]http://www.g-8.de/Content/EN/Artikel/__g8-summit/anlagen/2007-06-07-gipfeldokument-wirtschaft-eng,templateId=raw,property=publicationFile.pdf/2007-06-07-gipfeldokument-wirtschaft-eng.pdf.

promoting mutual trust and confidence and reaping the full benefits of SWFs for home and host countries".[92] Policy principles reflecting long-standing OECD commitments and consistent with OECD countries' rights and obligations under the organization's investment instruments should be, according to this document:

> Recipient countries should not erect protectionist barriers to foreign investment.
>
> Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.
>
> Where such national security concerns do arise, investment safeguards by recipient countries should be:
>
> – transparent and predictable,
> – proportional to clearly-identified national security risks,
> – subject to accountability in their application.[93]

Also published were explanatory "guidelines for recipient country investment policies relating to national security" formulated by the OECD Investment Committee in a report approved by member governments in April 2008 as another part of the "guidance".[94] The third component referred to in this document is the OECD general investment policy principles as established in the Code of Liberalization of Capital Movements[95] and the Declaration on International Investment and Multinational Enterprises.[96]

At the end of 2009, the OECD Committee on Fiscal Affairs invited comments on a public discussion draft concerning questions related to the application of tax treaties to state-owned entities, including SWFs, and also to the relevance of the principle of sovereign immunity[97] in tax matters.[98]

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[92]Message from the OECD secretary-general to the IMFC, 11 Oct. 2008, http://www.oecd.org/dataoecd/0/23/41456730.pdf, p. 1; see Chalamish, *Protectionism and Sovereign Investment post Global recession*, OECD, Dec. 2009, p. 6, http://www.oecd.org/dataoecd/31/22/44231385.pdf.

[93]OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies, 4-5 June 2008, http://www.oecd.org/dataoecd/0/23/41456730.pdf; see Gordon, *SWFs: OECD Guidance to Recipient Countri*es, 19 Feb. 2009, http://www.oecd.org/dataoecd/53/31/42204731.doc; see Mezzacapo, *The so-called "Sovereign Wealth Funds": regulatory issues, financial stability and prudential supervision*, 2009, pp. 73 et seq.

[94]Message from the OECD secretary-general to the IMFC, 11 Oct. 2008, http://www.oecd.org/dataoecd/0/23/41456730.pdf, pp. 4 et seq; also Recommendation adopted by the OECD Council, 25 May 2009, http://www.oecd.org/dataoecd/11/35/-43384486.pdf.

[95]2009 version, http://www.oecd.org/dataoecd/10/62/39664826.pdf.

[96]2000 version, http://www.oecd.org/dataoecd/56/36/1922428.pdf; see also the consultation note on a possible update, http://www.oecd.org/-dataoecd/-32/62/44168690.pdf.

[97]See below, pp. 773 et seq.

[98]http://www.oecd.org/dataoecd/59/63/44080490.pdf; on tax issues in general see Malone, Should the United States tax Sovereign Wealth Funds?, Boston University Int'l. L.J. 26 (2008), pp. 143 et seq.

Bank for International Settlements

The BIS, the World Bank and the European Central Bank jointly organized conferences on strategic asset allocation for central bank and sovereign wealth managers in 2008 and on portfolio and risk management for the same group of actors in 2009.[99] Moreover, a lot of speeches given by experts on various dates and at various places can be found on the Web site of this "bank of central banks", outlining the institutional structures, tasks and instruments of different SWFs and also analysing more general issues, such as the relationship between SWFs and global imbalances.[100] These documents might thus be another valuable information basis for shaping proper principles and rules for SWFs.

World Trade Organization

A rather singular contribution tries to demonstrate that the WTO would be the natural place for a bargain to be struck between countries with SWFs seeking secure and liberal access for their capital, and capital-importing countries that have legitimate concerns about the objectives and operations of SWFs, not least because GATS rules would already cover investments made by these funds.[101] The authors concede that to reach this end, the WTO would have to address exchange rate undervaluation in a much clearer and more detailed manner than it does now, in particular in Art. XV GATT (and Art. XI GATS).[102] A strong argument in favour of broadening WTO regulation in that way might be that its well-established dispute settlement mechanism would be available to resolve (or already prevent) conflicts,[103] e.g. if a member state were justified to take or apply restrictive measures based on "general" or "security exception" provisions (Arts. XIV, XIVbis GATS).[104]

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[99] http://www.bis.org/events/con081124saa.htm; http://www.bis.org/events/prm.htm.

[100] See, e.g., Gieve, *Sovereign wealth funds and global imbalances*, 14 Mar. 2008, http://www.bis.org/review/r080319d.pdf; Reddy, *Forex reserves, stabilization funds and sovereign wealth funds – Indian perspective*, 8 Oct. 2007, http://www.bis.org/review/r071009b.pdf.

[101] Mattoo/Subramanian, *Currency undervaluation and sovereign wealth funds: a new role for the World Trade Organization*, 2008, Peterson Institute, WP 08-2, p. 16.

[102] Mattoo/Subramanian, *Currency undervaluation and sovereign wealth funds: a new role for the World Trade Organization*, 2008, Peterson Institute, WP 08-2, pp. 9 et seq.

[103] Mattoo/Subramanian, *Currency undervaluation and sovereign wealth funds: a new role for the World Trade Organization*, 2008, Peterson Institute, WP 08-2, p. 19.

[104] See Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 321; von Rosenberg/Hilf/Kleppe, Protektion statt offener Märkte?, BB 2009, p. 834; Tietje, *Beschränkungen ausländischer Unternehmensbeteiligungen zum Schutz vor "Staatsfonds" – Rechtliche Grenzen eines neuen Interventionsprotektionismus*, Dec. 2007, p. 4, 9; Chalamish, *Protectionism and Sovereign Investment post Global recession*, OECD, Dec. 2009, p. 7, http://www.oecd.org/dataoecd/31/22/44231385.pdf.

This proposal, however, seems to ignore that if SWF activities are not excluded already from the types of "services" described in Art. I GATS,[105] market access and national treatment would only be open to other WTO parties if and insofar as these countries took relevant "positive" measures to open their economies for inward investments (Arts. XVI, XVII),[106] e.g. in the form of a "commercial presence".[107] And Russia as an important SWF home state, e.g., has not even taken the first step, i.e. to join the WTO as a new member.[108]

International Working Group of Sovereign Wealth Funds

In early 2008, the IWG was established,[109] comprising representatives from 25 IMF member countries. In April 2009, this body announced the setting up of the International Forum of Sovereign Wealth Funds, a voluntary group of SWFs,[110] which will meet to exchange views on issues of common interest and facilitate an understanding of the Santiago Principles and SWFs' activities. These 24 principles presented to the IMFC members in October 2008[111] are a common set of voluntary principles and practices intended to maintain the free flow of cross-border investment and to secure open and stable financial systems, thereby trying to promote a clearer understanding of the institutional framework, governance, and investment operations of SWFs deemed necessary for an open and stable investment climate worldwide. Since these principles should serve the purpose

> to identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements as well as the conduct of investment practices by SWFs on a prudent and sound basis,[112]

some of them will be looked at more closely below to find out if they could indeed become an adequate basis for a consistent and effective international normative framework.

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[105]See Annex on Financial Services, nos. 1 (b) (iii) and 5 (c) (i), but also no. 1 (c) and (d) which are more specific and thus prior to the general provisions laid down in Art. I (3) (c) GATS.

[106]In particular, lits. c) and f) of Art. XVI could be relevant; see Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 320.

[107]Art. XXVIII (d) GATS; see Chalamish, *Protectionism and Sovereign Investment post Global recession*, OECD, Dec. 2009, p. 7, http://www.oecd.org/dataoecd/31/22/44231385.pdf.

[108]http://www.wto.org/english/thewto_e/acc_e/a1_russie_e.htm.

[109]Press release: http://www.iwg-swf.org/pr/swfpr0801.htm.

[110]Press release: http://www.iwg-swf.org/pr/swfpr0901.htm.

[111]See the statement by Al-Suwaidi, 11 Oct. 2008, http://www.iwg-swf.org/pubs/eng/imfciwg.pdf.

[112]Sovereign Wealth Funds. General Accepted Principles and Practices (GAPP), see "Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, p. 4.

European Commission

A European Commission communication issued in early 2008[113] was quite right in stating that:

> In Europe, between the EU and the Member State level, there exists a comprehensive regime to regulate the establishment and the actions of foreign investors, which covers SWFs in exactly the same way as any other foreign investor. As soon as they invest in European assets, SWFs have to comply with the same national economic and social legislation that any other investors have to respect.

With regard to the current EU legal framework, the fundamental freedom of capital movements between member states as well as between EU members and third countries is not guaranteed without limits but may be regulated (and restrained) in two respects under Art. 64 (2) TFEU[114] (Art. 57 [2] EC). By qualified majority, any measures on the movement of capital from third states involving direct investment may be adopted. It is even allowed to introduce – by unanimous decision – measures that will restrict direct foreign investment.[115] Moreover, the Merger Regulation[116] based upon Art. 103 TFEU (Art. 83 EC) allows member states to take any necessary, non-discriminatory and proportionate measures which seem appropriate to protect legitimate interests (e.g. public security or prudential rules) other than competition if these are also compatible with other EU law provisions. Further, member states will also remain authorized to use instruments to condition and control foreign investments made by SWFs (or any other investor) as long as the enactment and application of such measures are compatible with the EU Treaty, i.e. not justified by purely economic grounds, taken in a proportionate and non-discriminatory manner and not contradicting international obligations of the EU or the (guest) state concerned.[117] Lastly, particularly with regard to network

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[113] A common European approach to Sovereign Wealth Funds, COM(2008) 115 final, 27 Feb. 2008.

[114] Treaty on the Functioning of the European Union, Consolidated Version, OJ 2008 C 115, pp. 47 et seq.

[115] See, e.g., Hindelang, Direktinvestitionen und die Europäische Kapitalverkehrsfreiheit im Drittstaatenverhältnis, JZ 2009, pp. 836 et seq.

[116] See Council Regulation (EC) 139/2004, OJ 2004 L 24, pp. 1 et seq., Art. 21(4); also Mezzacapo, *The so-called "Sovereign Wealth Funds": regulatory issues, financial stability and prudential supervision*, 2009, pp. 56 et seq.

[117] See Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 319 et seq.; Weller, Ausländische Staatsfonds zwischen Fusionskontrolle, Außenwirtschaftsrecht und Grundfreiheiten, ZIP 2008, p. 863; von Rosenberg/Hilf/Kleppe, Protektion statt offener Märkte?, BB 2009, p. 832; Hindelang, Direktinvestitionen und die Europäische Kapitalverkehrsfreiheit im Drittstaatenverhältnis, JZ 2009, p. 838; Tietje, *Beschränkungen ausländischer Unternehmensbeteiligungen zum Schutz vor "Staatsfonds" – Rechtliche Grenzen eines neuen Interventionsprotektionismus*, Dec. 2007, pp. 5 et seq.; also Bundesregierung, Deutscher Bundestag, Drucksache 16/7668, 3 Jan. 2008, pp. 2 et seq.

industries,[118] the general regulatory framework will often offer effective tools to protect legitimate public interests irrespective of foreign or domestic ownership.[119]

Nevertheless, the European Commission depicted a "case for a common approach" since

> clearing away unnecessary concerns makes it easier to maintain an open investment environment that allows the EU and its Member States to continue to reap the benefits of SWF investments.[120]

To deal with a global issue at an adequate stage by setting up multilateral solutions would be a first reason for this approach. Second, an uncoordinated series of individual national responses would be dangerous because it might fragment the internal market based on open and non-discriminatory rules. And last, one of the main goals of EU trade policy has been and continues to be to open third-country markets to EU investors on the basis of the same principles which were introduced to govern a well-functioning internal market.[121]

Thus, the European Commission communication insists on

> a cooperative effort between recipient countries and SWFs and their sponsor countries to establish a set of principles ensuring the transparency, predictability and accountability of SWF investments. It is essential that all relevant actors are actively involved and have ownership in the creation of a balanced and stable framework covering SWF investments.[122]

Leading principles should be, according to the European Commission (and quite similar to the OECD proposals[123]), a commitment to an open investment environment, support of multilateral work, use of existing instruments, respect of EU Treaty obligations and international commitments and, finally, proportionality

[118] See Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 316; Schmid/Bürki, Die Bedeutung von Staatsfonds für die Schweiz, Die Volkswirtschaft 2008, p. 24.

[119] See Krolop, Schutz vor Staatsfonds und anderen ausländischen Kapitalmarktakteuren unter Ausblendung des Kapitalmarktrechts?, ZRP 2008, p. 41; Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 322; Fraktion BÜNDNIS 90/DIE GRÜNEN, Deutscher Bundestag, Drucksache 16/9612, 18 June 2008, pp. 5 et seq.; but also see Kaufmann, *Investoren als Invasoren*, 2009, pp. 12 et seq.

[120] A common European approach to Sovereign Wealth Funds, COM(2008) 115 final, 27 Feb. 2008, p. 6.

[121] See Krolop, Schutz vor Staatsfonds und anderen ausländischen Kapitalmarktakteuren unter Ausblendung des Kapitalmarktrechts?, ZRP 2008, p. 43; Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, pp. 318 et seq.; Weller, Ausländische Staatsfonds zwischen Fusionskontrolle, Außenwirtschaftsrecht und Grundfreiheiten, ZIP 2008, pp. 862 et seq.

[122] A common European approach to Sovereign Wealth Funds, COM(2008) 115 final, 27 Feb. 2008, p. 7.

[123] See below, pp. 429 et seq.

and transparency.[124] Based thereupon, the European Commission pleads for the introduction of some principles of good governance as well as some transparency practices.

Whether the European Commission communication will lead to visible normative results seems, however, rather doubtful. It should not only have served to foster efforts to set up a code of conduct for SWFs and for their owners – which led to the Santiago Principles as a first basic document – and to the (OECD) work to define principles applied by recipient countries when dealing with SWFs, but it should also have helped to reach an agreement on a set of guidelines, “preferably by the end of 2008”.[125] At least this date has surely been missed.

Preliminary Conclusions

Summing up the proposals delineated above and some other policy ideas that are currently being circulated, several viable policy responses to the (real as well as presumed) risks associated with SWFs may be distinguished.

First, EU officials[126] and other politicians are calling for increased transparency requirements related to actual portfolio positions of SWFs, their investments and operations. A more far-reaching development is new or stricter national legislation in some industrial countries, e.g. in Germany,[127] intended to block SWFs from taking major stakes in companies in any strategic sectors of the economy although these provisions are not explicitly or solely aimed at direct investments made by such funds.[128]

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[124] A common European approach to Sovereign Wealth Funds, COM(2008) 115 final, 27 Feb. 2008, p. 8. For some transparency rankings see Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, pp. 15 et seq.

[125] A common European approach to Sovereign Wealth Funds, COM(2008) 115 final, 27 Feb. 2008, p.10.

[126] Mandelson, *Putting sovereign wealth in perspective*, http://ec.europa.eu/commission_barroso/speeches_articles/sppm196_en.htm; see also Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, p. 8.

[127] 13. Gesetz zur Änderung des Außenwirtschaftsgesetzes und der Außenwirtschaftsverordnung, 18 April 2099, BGBl. I, 770 pp. et seq.; see von Rosenberg/Hilf/Kleppe, Protektion statt offener Märkte?, BB 2009, pp. 831 et seq.; Seibt/Wollenschläger, Unternehmenstransaktionen mit Auslandsbezug nach der Reform des Außenwirtschaftsrechts, ZIP 2009, pp. 833 et seq.; Müller/Hempel, Änderungen des Außenwirtschaftsrechts zur Kontrolle ausländischer Investoren, NJW 2009, pp. 1638 et seq.; Krolop, Schutz vor Staatsfonds und anderen ausländischen Kapitalmarktakteuren unter Ausblendung des Kapitalmarktrechts?, ZRP 2008, p. 40.

[128] Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 316; Müller-Ibold, Foreign Investment in Germany: Restrictions Based on Public Security Concerns and Their Compatibility with EU Law, EYIEL 1 (2010), p. 103; Weller, Ausländische Staatsfonds zwischen Fusionskontrolle, Außenwirtschaftsrecht und Grundfreiheiten, ZIP 2008, p. 857; *Wirtschaft kritisiert deutsche Abschottung*, Börsen-Zeitung, 21

A second line of arguments is based upon reciprocity as a (quite) less strict guideline for granting market access for foreign SWFs. Those entities would thus only be allowed to invest in a recipient country if (private as well as public) enterprises domiciled there would also be permitted to invest freely in the SWF's home state. Since a lot of large SWFs are located in the Gulf States and (South) East Asia, which would in the past perhaps have been less liberal relating to financial matters than typical OECD countries,[129] a strict application of the reciprocity principle would place strong limitations on those (group of) SWF investments. On the other hand, several Western countries have concluded reciprocal bilateral investment treaties with various Asian states,[130] and the scope of application of these agreements is normally rather broad so that they probably do not only protect investments made by private companies located in the territory of the other party.[131]

A third suggestion[132] argues that if SWFs were forced to invest through intermediary asset managers, most risks associated with those entities would be mitigated, if not avoided at all. The added benefit of such an indirect investment philosophy would be that it might generate a better risk–return profile.

Fourth, today considerable political momentum seems to foster the idea of a code of conduct or a set of guidelines that SWFs would adopt on a voluntary basis in an attempt to alleviate (political) concerns in the most important mature (target) markets. So there would have to be identified "best practices" in areas such as institutional structure, risk management, transparency and accountability. But any efforts to develop a set of "good governance guidelines" might fail or would prove to be counterproductive if the demands from industrialized (recipient) countries are to ambitious, or if such guidelines were ultimately motivated by a "protectionist"

Aug. 2008; von Rosenberg/Hilf/Kleppe, Protektion statt offener Märkte?, BB 2009, p. 831; Voland, Freitag, der Dreizehnte – Die Neuregelungen des Außenwirtschaftsrechts zur verschärften Kontrolle ausländischer Investitionen, EuZW 2009, p. 519; see also Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, pp. 17 et seq.; O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, Sept. 2008, pp. 12 et seq.; Malone, Should the United States tax Sovereign Wealth Funds?, Boston U. Int'l. L.J. 26 (2008), pp. 172 et seq., referring to the US Foreign Investment and National Security Act of 2007.

[129] Kern, *Staatsfonds – Staatliche Auslandsinvestitionen im Aufwind*, DBResearch, 18 Dec. 2007, p. 18; but also Raphaeli/Gersten, Sovereign Wealth Funds: Investment Vehicles for the Persian Gulf Countries, Middle East Quarterly, Spring 2008, pp. 45 et seq.

[130] See, e.g., the list of German BITs, http://www.unctad.org/sections/ditepcbb/docs/bits_Germany.pdf; for more general information, see http://www.unctadxi.org/templates/Startpage____718.aspx.

[131] For a proposal of a (new) multilateral agreement on investment see Fraktion BÜNDNIS 90/DIE GRÜNEN, Deutscher Bundestag, Drucksache 16/9612, 18 June 2008, p. 1.

[132] See Das/Lu/Mulder/Sy, *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, IMF Working Paper, August 2009, WP/09/179, p. 18.

desire in those countries to impose (veiled) barriers to foreign and, in particular, SWF investments.[133]

Thus, any normative framework – whether it be hard or "soft"[134] – will have to adequately solve two central issues if it is to be effective. First, to quell the concern of recipient countries with respect to politically motivated investments, it must contain governance prescriptions that would ensure that investment decisions of SWFs are not driven by ("unfriendly") political objectives of the SWF's home state. And second, to preclude a resurgence of state "capitalism" in Western market-economy countries,[135] rules for SWFs need to spell out upper limits to investment stakes in foreign private companies, at least in normal times.[136]

Elements of an International Normative Framework for SWFs

International Investment Law

Until now, only very few general multilateral investment treaties have come into force.[137] International investment law is thus nearly exclusively based upon far more than 2,000 bilateral agreements (BITs).[138] Even if most of them use the same or at least a very similar definition of "investment" and "investor" so that the scope of application of each of these treaties is nearly like that of any other treaty,[139] this current national approach seems only a second-best solution.[140] But it may be a

[133]On "investment protectionism" see Chalamish, *Protectionism and Sovereign Investment post Global recession*, OECD, Dec. 2009, pp. 4 et seq., http://www.oecd.org/dataoecd/31/22/44231385.pdf.

[134]For a "soft" solution see Mezzacapo, *The so-called "Sovereign Wealth Funds": regulatory issues, financial stability and prudential supervision*, 2009, pp. 41, 82.

[135]See Weller, Ausländische Staatsfonds zwischen Fusionskontrolle, Außenwirtschaftsrecht und Grundfreiheiten, ZIP 2008, p. 858, quoting Lawrence Summers; Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, p. 14.

[136]In the same sense see Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, pp. 10 et seq.

[137]See Dolzer, *For a Multilateral Investment Treaty: An Agenda for the Future*, Sept. 2004, http://www.kas.de/proj/home/pub/37/1/year-2004/dokument_id-5281/index.html; Kläger, Einführung in das internationale Enteignungs- und Investitionsrecht, JuS 2008, p. 972.

[138]See Sauvant/Maschek/McAllister, *Foreign Direct Investment by Emerging Market Multinational Enterprises, the Impact of the Financial Crisis and Recession and Challenges Ahead*, OECD, Dec. 2009, p. 13.

[139]See Kläger, Einführung in das internationale Enteignungs- und Investitionsrecht, JuS 2008, p. 972; Krajewski/Ceyssens, Internationaler Investitionsschutz und innerstaatliche Regulierung, AVR 45 (2007), pp. 186 et seq.

[140]Although there is evidently a "network" of multilateral as well as bilateral economic agreements concluded by various individual EU countries with third states, one might ask whether

remarkable phenomenon that BITs normally do not make any distinctions between private and public investors.[141] So, investments made by the latter group must be treated like private ones unless the parties of an investment treaty have agreed upon (explicit) specific exceptions based on public interests justifying restrictions only or at least primarily in respect of state-owned firms or funds. And another lesson to be learnt from the example of bilateral treaties is that even then no host or recipient country seems to have gone so far as to grant a right of admission to (i.e. a "right to invest" in) a foreign territory to the other (state) party or to a (private) investor from that (home) state.[142] These two basic rules might be appropriate also for a multilateral framework. But the OECD "guidance" shows that it would lead to much more legal certainty if specific criteria for "national security" exceptions or restrictions were laid down explicitly.

Taking into account the work of the OECD as well as its predecessor OEEC on the protection of foreign investment, it seems hardly astonishing at all that the OECD has been eager to play a major role in the process of developing rules for SWFs too. But it should not be forgotten that none of two main projects in the past – neither the convention of 1967[143] nor the Multilateral Agreement on Investment in the 1990s[144] – succeeded, although they probably failed for different reasons. At least from a historical perspective, investment treaties were most often concluded between capital-exporting and capital-importing countries so the first ones could grant reciprocal treatment to the latter ones without hesitation because they did not really have to worry about major investments made by enterprises domiciled in the territory of the other party. In other words, there was a rather sharp divide between "Northern" developed capital-exporting home states and "Southern" developing host countries which were forced by their need to attract foreign (direct) investment for development purposes to create a favourable legal "climate" for that. There is, however, no such clear regional distinction between different SWFs, so any country

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a solution at the supranational level would be more effective since this would also prevent distortion of competition between EU members; see Krolop, Schutz vor Staatsfonds und anderen ausländischen Kapitalmarktakteuren unter Ausblendung des Kapitalmarktrechts?, ZRP 2008, p. 44.

[141] Chalamish, *Protectionism and Sovereign Investment post Global recession*, OECD, Dec. 2009, p. 8, http://www.oecd.org/dataoecd/31/22/44231385.pdf; Houde, Novel Features in Recent OECD Bilateral Investment Treaties, quite similarly under primary EU law, in: OECD, *International Investment Perspectives*, 2006, pp. 149 et seq.; Yannaca-Small, Definition of Investor and Investment in International Investment Agreements, in: OECD, *International Investment Law: Understanding Concepts and Tracking Innovations*, 2008, pp. 38 et seq.; see Weller, Ausländische Staatsfonds zwischen Fusionskontrolle, Außenwirtschaftsrecht und Grundfreiheiten, ZIP 2008, p. 863; Hindelang, Direktinvestitionen und die Europäische Kapitalverkehrsfreiheit im Drittstaatenverhältnis, JZ 2009, p. 835; in respect of Australian law see Golding/Bassil, *Australian Regulation of Investments by Sovereign Wealth Funds and State Owned Enterprises*, 2008, pp. 6 et seq.

[142] Chalamish, *Protectionism and Sovereign Investment post Global recession*, OECD, Dec. 2009, p. 8, http://www.oecd.org/dataoecd/31/22/44231385.pdf; Kläger, Einführung in das internationale Enteignungs- und Investitionsrecht, JuS 2008, p. 973.

[143] Draft Convention on the Protection of Foreign Property, http://www.oecd.org/dataoecd/35/4/39286571.pdf.

[144] Draft Consolidated Text of April 1998, http://www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf.

whether it be the home of or host to those entities might be eager to take part in an appropriate, i.e. global, forum to protect its interests.[145] And moreover, since SWFs are a group of investors using similar instruments for their operations, although based upon (probably) different strategies and (political) motives, it might be easier to come to an agreement upon issues of general relevance than in the case of multinational enterprises. Although some of the largest SWFs reached their actual size by their involvement in the recycling of petrodollars and their home states have been members of the OPEC from the beginning, even these funds never tried to imitate the structure and the attitudes of this "cartel" of oil-exporting countries[146] since it would have been rather unwise to establish an organization or to conclude an agreement with restricted membership when (almost) every state is able to set up a SWF – and should thus be authorized to join the (global) club.

GAPP: Nature, Content and Scope

Purpose, Membership, Organization

The "nature" of the Santiago Principles is explained as follows within the section on "objective and purpose":

> The GAPP is a voluntary set of principles and practices that the members of the IWG support and either have implemented or aspire to implement [,] subject to provisions of intergovernmental agreements, and legal and regulatory requirements. Thus, the implementation of each principle of the GAPP is subject to the applicable home country laws. [SWFs] comply with applicable regulatory and disclosure requirements in their home countries and in the countries in which they invest.

Later, another phrase, inserted before Principle 1 as "an integral part of the GAPP" confirms:

> In furtherance of the 'Objective and Purpose', the IWG members either have implemented or intend to implement the following principles and practices, on a voluntary basis, each of which is subject to home country laws, regulations, requirements and obligations.

The term "IWG members" refers to 26 countries with SWFs, some other states as well as international organizations (OECD, IBRD) being permanent observers, and the IMF facilitates and coordinates the IWG's work, and acts as its secretariat.

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[145] On the reversal of global capital flows see Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, p. 7; on issues of legitimacy Sauvant/Maschek/McAllister, *Foreign Direct Investment by Emerging Market Multinational Enterprises, the Impact of the Financial Crisis and Recession and Challenges Ahead*, OECD, Dec. 2009; Sauvant/Maschek/McAllister, *Foreign Direct Investment by Emerging Market Multinational Enterprises, the Impact of the Financial Crisis and Recession and Challenges Ahead*, OECD, Dec. 2009, pp. 22 et seq.

[146] See Terhechte, *OPEC und europäisches Wettbewerbsrecht*, 2008, pp. 46 et seq.

In April 2009, the IWG passed a “Kuwait Declaration”[147] to establish the International Forum of Sovereign Wealth Funds. According to its statute, this forum is

> a voluntary group of SWFs [t]he purpose [of which] will be to meet, exchange views on issues of common interest, and facilitate an understanding of the Santiago Principles and SWF activities. [It] shall not be a formal supranational authority and its work shall not carry any legal force (A. – Purpose).
>
> The Forum members shall be the SWFs who participated in the IWG and endorsed the Santiago Principles. Membership will be open to other Funds who meet the Santiago Principles definition of a SWF and endorse the Santiago Principles (C. – Membership).

At the end of 2009, there were 23 forum members.

The organizational structure of the forum is rather lean. The declaration only provides for a “professional secretariat” to facilitate the activities of the forum and its subgroups, as well as efficient cooperation and communication among its members and with other relevant parties.[148]

So, currently there is evidently not yet any “hard” international legal framework of SWFs. Moreover, the forum, on the one hand, intends to act as a platform also for

> encouraging cooperation with investment recipient countries, relevant international organizations, and capital market functionaries to identify potential risks that may affect cross-border investments, and to foster a non-discriminatory, constructive and mutually beneficial investment environment (A. – Purpose, 3),

but its members are solely SWFs themselves, and these entities alone are entitled to nominate up to three senior-level officials (of the SWFs, its owners or governing body/bodies) as its representatives (C. – Membership).

Are there any chances that this “soft law” model could be transformed into (multilateral) international treaty law?[149] Before trying a greenfield approach, i.e. setting up a new intergovernmental institution or convention, it might be more promising to ask whether an existing one would take care of (at least some) SWF issues. Neither the IMF nor the IBRD has been willing to take the lead, probably because their involvement was deemed restricted by their respective articles of agreement in various ways. At least, however, the IMF has been active as a catalyst and supporter. For similar reasons, the WTO might hardly be the appropriate place to debate a normative framework for SWFs. Even if their operations and transactions were not excluded from the concept of (financial) “services” because of Art. I (3) (b), (c) GATS,[150] there would remain doubt as to which kind of “general” or

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[147]Published at http://www.iwg-swf.org/mis/kuwaitdec.htm.; see Nugée, SWFs’ Coming of Age: Unrivaled Titans to Uncertain Mortals, in: Hoguet/Nugée/Rozanov (eds.), *Vision: Sovereign Wealth Funds. Emerging from the Financial Crisis*, 2009, p. 7.

[148]See Declaration, http://www.iwg-swf.org/mis/kuwaitdec.htm, Fn. 5 to D. – Structure of the Forum.

[149]The same question was asked, but a different answer was given by Chalamish, *Protectionism and Sovereign Investment post Global recession*, OECD, Dec. 2009, p. 10, http://www.oecd.org/dataoecd/31/22/44231385.pdf.

[150]See above, pp. 481 et seq.

"additional" obligations provided for in this "multilateral" agreement would be adequate for them, and, as in the case of the IMF, the entities concerned would not be permitted to take part in the drafting of rules they would be bound to comply with later. But if there thus seems to be no way to avoid the modification of existing treaties, then it might be appropriate to consider the model of the ITU constitution where recognized (private) entities were increasingly involved in the decision-making process during the last 10 years to improve the results as well as their acceptance by the enterprises concerned.[151]

Improvement by Disclosure?

Looking once again at the model of the Santiago Principles, these cover practices (without defining what is meant by this term, in particular whether it would refer to "best" practices) and principles in three key areas:

> (i) legal framework, objectives, and coordination with macroeconomic policies,
> (ii) institutional framework and governance structure; and
> (iii) investment and risk management framework.[152]

Only two of 24 principles explicitly deal with the relationship between SWFs and host or recipient countries:

> SWF activities and operations in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate (GAPP 15).

> Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries (GAPP 17).

The obligation to "disclose publicly" and – used only a little less often – the duty to "define clearly" will be found in most of the GAPP. The "legal" and the "governance" framework should be "sound", as should the "asset management principles" (GAPP 1, 6, 19.2). Only rarely are there somewhat more substantial requirements, such as "operational independence" and "accountability". But these terms, too, are rather vague (GAPP 6, 9, 10, 16). So, the main goal of the GAPP seems to be not to disturb the "circles" of the owner[153]: It is he who sets the "objective", the "investment strategy" and "policy" (GAPP 7, 18, 19), who appoints the members of the SWF's governing body/bodies (GAPP 8) and exercises oversight over its operations, and if there would be any doubts about the scope of those broad discretionary powers, subprinciple 19.1 would definitely destroy them:

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[151]Basic rules on "sector members" are laid down in Art. 3(1),(3) of this international treaty, http://www.itu.int/net/about/basic-texts/constitution/chapteri.aspx.

[152]"Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, see http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, p. 5 (Structure).

[153]Quite similarly, Schneider, Die Santiago-Principles – am Problem vorbei, EuZW 2009, p. 553.

> If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

Of course, either soft law rules or treaty provisions could try to lay down more precise rights and obligations of SWFs. But then the chance to reach a consensus between all major actors concerned would surely be very small since recipient country governments would hardly be ready to liberalize capital imports without limits and, moreover, would surely reserve their right to determine whether (economic) activities of foreigners within their territory should be prohibited or restricted for public policy reasons.[154] Thus, as long as there will be no general freedom for inward investment even for (foreign) private enterprises, SWFs will not (and should not) be treated any better than the former. If, however, foreign investments have been explicitly allowed by host state legislation and/or administrative authorities and the relevant transaction processes have been performed, the invested assets are protected by BITs[155] and (sometimes) also by other international legal instruments, and then, also SWFs could claim to get most-favoured-nation treatment as well as national treatment in respect of their relevant "investments".[156]

Dispute Settlement Under GAPP?

The last of the Santiago Principles (GAPP 24) recognizes, although rather vaguely,[157] that

[154]For differing views see, e.g., Seibt/Wollenschläger, Unternehmenstransaktionen mit Auslandsbezug nach der Reform des Außenwirtschaftsrechts, ZIP 2009, pp. 839 et seq.; European Parliament resolution of 9 July 2008 on SWFs, OJ 2009 C 294E, no. 6; Fraktion BÜNDNIS 90/DIE GRÜNEN, Deutscher Bundestag, Drucksache 16/9612, 18 June 2008, p. 2; although it seems quite remarkable that sec. 7(2) no. 6 in combination with sec. 7(1) no. 4 of the German Reform Act refers directly to the relevant provisions of the EC Treaty (Arts. 46 and 58 [1], i.e. now Arts. 52, 65 [1] TFEU), this relationship might not lead to sufficient legal clarity; see Voland, Freitag, der Dreizehnte – Die Neuregelungen des Außenwirtschaftsrechts zur verschärften Kontrolle ausländischer Investitionen, EuZW 2009, pp. 521 et seq.; also Müller/Hempel, Änderungen des Außenwirtschaftsrechts zur Kontrolle ausländischer Investoren, NJW 2009, p. 1640; for a rather liberal approach, see the "principles guiding consideration of foreign government related investment in Australia" of Feb. 2008, see Golding/Bassil, *Australian Regulation of Investments by Sovereign Wealth Funds and State Owned Enterprises*, 2008, pp. 11 et seq; but theory and practice seems to differ rather widely; see O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, Sept. 2008, pp. 15 et seq.

[155]Since 1 December 2009, "foreign direct investment" has been part of the EU common commercial policy under Art. 207 TFEU; see Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 321; Tietje, *Beschränkungen ausländischer Unternehmensbeteiligungen zum Schutz vor "Staatsfonds" – Rechtliche Grenzen eines neuen Interventionsprotektionismus*, Dec. 2007, p. 8.

[156]See Krajewski/Ceyssens, Internationaler Investitionsschutz und innerstaatliche Regulierung, AVR 45 (2007), pp. 196 et seq.

[157]See Nugée, SWFs' Coming of Age: Unrivaled Titans to Uncertain Mortals, in: Hoguet/Nugée/Rozanov (eds.), *Vision: Sovereign Wealth Funds. Emerging from the Financial Crisis*, 2009, p. 7;

> a process of regular review of implementation of the GAPP should be engaged in by or on behalf of the SWF.

The message on "objective and purpose" is somewhat clearer:

> [A]s the macroeconomic and financial stability implications of SWF investments change and SWF practices develop, some aspects of the GAPP may need re-examination. Continuing coordination and consultation at the international level also could be desirable on issues of common interest to SWFs.[158]

Therefore, the IWG agreed to explore the establishment of a standing group of SWFs able to keep the GAPP under review, if appropriate. The forum set up by the Kuwait Declaration is only the first result of the discussion since the task of this "platform" does not explicitly refer to "review" powers but merely provides for "sharing views on the application of the Santiago Principles including operational and technical matters" (A – Purpose, 2.).

On the other hand, even major intergovernmental organizations such as the IMF and the WTO are not authorized by their articles of agreement to exercise supervisory or control powers on behalf of non-state actors, and in the course of trade policy reviews (Art. III WTO agreement) or surveillance activities (Art. IV IMF articles of agreement) in respect of members, the relevant bodies of these institutions will only be able to assess or evaluate a member's performance but they must refrain from giving orders or instructions to the state concerned on how it should correct mistakes or change its policies and measures.

Another topic for an adequate SWF regime which was not dealt with in the GAPP is dispute settlement if (legal) conflicts arise between a fund and a particular recipient country. If there were actually relevant GATS obligations for the latter,[159] the WTO mechanism would come into play if the SWF home state were also a party to the WTO treaty since both GATS and the DSU are "multilateral" instruments (Art. II [2] WTO agreement). But only the home state itself could claim to be violated in its treaty rights, whereas the SWF might merely ask the panel or appellate body for permission to present its view as an amicus curiae.[160]

So, it would be much better to address a request for conciliation (Arts. 28 et seq.) or arbitration (Arts. 36 et seq. ICSID convention) to the secretary-general of the ICSID, at least if the SWF home state as well as the recipient state were contracting parties to this convention. Then, the SWF might claim that the dispute had arisen

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Mezzacapo, *The so-called "Sovereign Wealth Funds": regulatory issues, financial stability and prudential supervision*, 2009, p. 71.

[158]"Santiago Principles" of the International Working Group of Sovereign Wealth Funds, Oct. 2008, see http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf, p. 6.

[159]See above, pp. 481 et seq.

[160]See Weiss, WTO-Streitbeilegung, in: Tietje (ed.), *Internationales Wirtschaftsrecht*, 2009, pp. 770, 783 and 787.

directly out of an "investment",[161] that it had to be treated as a "national of another Contracting State" (according to Art. 25 [2] [b]) and that both parties to the dispute had consented in writing to submit their case to the ICSID (Art. 25 [1]). Relevant clauses recognizing the jurisdiction of the ICSID for state–investor disputes will be found in many BITs.[162]

Recognition and enforcement of ICSID arbitral awards would then take place according to Art. 54 of the convention, but that provision must not be construed as derogating from laws relating to (state) immunity from execution.[163] Although the party benefiting from this rule will normally be the "other contracting state", it might occur "that pecuniary obligations would be also imposed on the other party, i.e. a SWF, so that the question will be raised whether this entity could claim to be protected by sovereign immunity, too".[164] Since states became increasingly engaged in commercial activities abroad, courts in a lot of jurisdictions began to apply a "restrictive theory of immunity" at least in cases brought by private enterprises.[165] Under this approach, immunity will be denied for "commercial" acts. A primary purpose of this exception is to protect the legitimate expectations of business partners that start commercial transactions with foreign states. Although the restrictive approach which generally applies both to immunity from jurisdiction and to immunity from execution (barring a state from taking coercive measures against another state's assets for the purpose of enforcing a judgment) is now widely recognized, countries show wide divergences in the implementation of the doctrine. For example, national laws define "foreign state" rather differently.[166] Moreover, different jurisdictions use differing approaches both to foreign state-owned enterprises and to foreign central banks; the latter seem to have been increasingly singled out by courts of major countries for reinforced

[161]For more details, see Reinisch, Die Beilegung von Investitionsstreitigkeiten, in: Tietje (ed.), *Internationales Wirtschaftsrecht*, 2009, pp. 810 et seq.; see also Houde, Novel Features in Recent OECD Bilateral Investment Treaties, quite similarly under primary EU law, in: OECD, *International Investment Perspectives*, 2006, pp. 145 et seq.; Yannaca-Small, Definition of Investor and Investment in International Investment Agreements, in: OECD, *International Investment Law: Understanding Concepts and Tracking Innovations*, 2008, pp. 59 et seq.

[162]See Krajewski/Ceyssens, Internationaler Investitionsschutz und innerstaatliche Regulierung, AVR 45 (2007), pp. 211 et seq.

[163]Art. 55; see Schreuer, *The ICSID Convention: A Commentary*, 2001, pp. 1146 et seq.

[164]See Malone, Should the United States tax Sovereign Wealth Funds?, Boston University Int'l. L. J. 26 (2008), pp. 180 et seq.; also 11th (OECD) Roundtable on Freedom of Investment, National Security and "Strategic" Industries, 7 Oct. 2009, Summary, nos. 4 et seq.

[165]See, e.g., (German) Federal Constitutional Court, *National Iranian Oil Company*, 12 April 1983, BVerfGE 64, pp. 1 et seq.; US Sup. Ct., *Republic of Argentina vs. Weltover, Inc.*, 12 June 1992, 504 U.S. 607 (1992).

[166]See Enderlein, Zur rechtlichen Selbständigkeit sozialistischer staatlicher Unternehmen in den internationalen Wirtschaftsbeziehungen, RIW 1988, p. 334; also Malone, Should the United States tax Sovereign Wealth Funds?, Boston U. Int'l. L.J. 26 (2008), pp. 183 et seq.

immunity in recent years.[167] Thus, to say the least, this issue is highly complex and the practices among countries are far from uniform, and Art. 55 of the ICSID Convention does not solve the problem either since it merely refers to (other) existing laws in force.

SWFs and the Financial Market Crisis

It might be pure coincidence that debates on SWFs at international and national levels started nearly at the same time as the financial market crisis arising from non-performing subprime loans in the USA was becoming global. But very spectacular SWF transactions took place in 2008 just because some big private enterprises, mostly banks, were in urgent need of new capital and evidently did not care very much about from where to get it. "Some of the prominent names on Wall Street – from Merrill Lynch to Citigroup and Morgan Stanley – turned to investment funds controlled by foreign governments"[168] The biggest Swiss bank seemed to have been lucky to find a new strong shareholder from Southeast Asia,[169] and Arab SWFs acquired (mostly minor) equity holdings in major German enterprises (such as Volkswagen, Daimler and Deutsche Bank).[170]

Although it would be foolish to dismiss the idea that SWFs might exercise political power in ways that Western countries will find uncomfortable, this legitimate caution should not spill over into illegitimate hysteria causing ever-broader restrictions on foreign investment in general. And furthermore, if and as long as governments in China, Russia and the Middle East countries have large investments in the USA and the EU,[171] then they should also be eager not to disturb the continuing prosperity of these recipient states. Thus, as the behaviour of (non-Western)

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[167]See 11th (OECD) Roundtable on Freedom of Investment, National Security and "Strategic" Industries, 7 Oct. 2009, Summary, no. 9.

[168]Rachman, *Do not panic over foreign wealth*, Financial Times, 29 April 2008; see also *Abu Dhabi beteiligt sich mit fast 5 Prozent an Citigroup* and commentary titled *Ein Hoffnungszeichen*, NZZ no. 277, 28 Nov. 2007; *Abu Dhabis Staatsfonds Adia verklagt die Citigroup*, NZZ no. 293, 17 Dec. 2009; Aizenmann/Glick, *Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance*, 2008, p. 20; O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, Sept. 2008, p. 3.

[169]See Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 315; Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, pp. 12 et seq.; *Der Schweizer Finanzplatz weckt das Interesse ausländischer Investoren*, NZZ no. 288, 11 Dec. 2007; *Verluste beim Staatsfonds GIC. Singapur hält an UBS fest*, NZZ no. 226, 30 Sept. 2009.

[170]*Arabischer Einstieg bei Daimler willkommen*, NZZ no. 69, 24 March 2009; *Dem Emirat Katar gehören 10 Prozent an Porsche*, NZZ no. 203, 3 Sept. 2009; *Conti flirtet mit Kuwait*, Wirtschaftswoche, 20 July 2009; also Kaufmann, *Investoren als Invasoren*, 2009, pp. 27 et seq.

[171]See also *Libyscher Staatsfonds steigt bei Wienerberger ein*, NZZ no. 213, 15 Sept. 2009; *Allianz mit libyschem Staatsfonds*, NZZ no. 176, 3 Aug. 2009.

SWFs during recent years has shown, the most important political implications of investments by those funds are positive.[172] Deep (and reciprocal) investment links obviously make it less likely that political differences will escalate into conflict.

New Rules Needed?

Whereas the Santiago Principles as well as other soft law – such as the various OECD guidelines – will hardly be an adequate and lasting response to challenges raised by SWFs, a broader and more precisely formulated binding legal document might be neither realistic nor really needed at all. The principle of freedom of investment will not be discarded by different national legislation in respect of certain or all foreign investments when these are based upon a common understanding that prohibitions or restrictions will only be legitimate (and thus not "protectionist"[173]) if a state's public order or public security would be genuinely and seriously threatened by those investments, and that protective measures should be taken in exceptional cases solely.[174] In general, transparency rules complemented by notification and reporting procedures ("disclosure") might be sufficient to calm fears which were often kindled by too little information about SWFs, their objectives, purposes, strategies and policies.[175] As Peter Mandelson said quite distinctly at an OECD conference in March 2008[176]:

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[172]*Zunehmende Integration der Staatsfonds in das Finanzsystem*, NZZ no. 191, 20 Aug. 2009; Baumberger, *Macht und Ohnmacht von Staatsfonds*, NZZ no. 47, 26 Feb. 2008; *Die arabischen Staatsfonds in der Krise*, FAZ, 5 May 2009; see also Jost, *Sovereign Wealth Funds – Size, Economic Effects and Policy reactions*, HAW Diskussionspapier 13, Jan. 2009, p. 11.

[173]Hildebrand, *The Challenge of Sovereign Wealth Funds*, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, p. 14; Schaumann/Kündig, *Staatliche Investitionsfonds – wichtig und unumgänglich*, NZZ no. 107, 7 May 2008; Nugée, SWFs' Coming of Age: Unrivaled Titans to Uncertain Mortals, in: Hoguet/Nugée/Rozanov (eds.), *Vision: Sovereign Wealth Funds. Emerging from the Financial Crisis*, 2009, p. 6; Kern, *Staatsfonds – Staatliche Auslandsinvestitionen im Aufwind*, DBResearch, 18 Dec. 2007, p. 23.

[174]For a profound analysis of existing rules, see Yannaca-Small, Essential Security interests under International Investment Law, in: OECD, *International Investment Perspectives: Freedom of Investment in a Changing World*, 2007, pp. 93 et seq.

[175]Quite similarly, see Martini, Zu Gast bei Freunden?: Staatsfonds als Herausforderung an das europäische und internationale Recht, DÖV 2008, p. 322; BDI/BdB/GDVW, *Gemeinsame Erklärung: Investitionsfreiheit und ausländische Staatsfonds*, 31 Oct. 2007, http://www.bankenverband.de/print.asp?artid=2215&channel=133810; Hesse, *Regeln für Staatsfonds*, Süddeutsche Zeitung, 19 Jan. 2008; Gnath, *Die unbekannte Macht der Staatsfonds*, DGAPstandpunkt, Oct. 2007, no. 7, pp. 1 et seq.; Beck/Fidora, The impact of sovereign wealth funds on global financial markets, ECB Occasional Paper 91, 2008, p. 24; FDP-Fraktion, Deutscher Bundestag, Drucksache 16/6997, 7 Nov. 2007, p. 4; O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, Sept. 2008, p. 25.

[176]See Mandelson, *Putting sovereign wealth in perspective*, http://ec.europa.eu/commission_barroso/speeches_articles/sppm196_en.htm; see also Hildebrand, *The Challenge of Sovereign*

SWFs are in fact a relatively uncomplicated part of the state capitalism picture. Monopolistic practices, market abuse and distortion of trade by state business are a lot more worrying. When SWFs invest transparently and diversely, avoiding controversial sectors and acting sensitively in acquiring large stakes – as they have up to now – their state patronage is not in itself a case of concern.

Wealth Funds, International Center for Monetary and Banking Studies, Geneva, 18 Dec. 2007, http://www.snb.ch/en/mmr/speeches/id/ref_20071218_pmh/source/ref_20071218_pmh.en.pdf, p. 8.

Sovereign Wealth Funds: Market Investors or "Imperialist Capitalists"? The European Response to Direct Investment by Non-EU State-Controlled Entities

Heike Schweitzer

Introduction

During the last 3 years or so, the international investment activities of sovereign wealth funds (SWFs) have captured the attention of national and international policy makers and have raised serious concerns. There is a wide-spread fear that SWFs' investment decisions may be guided by political and geo-strategic rationales rather than by the traditional market-oriented mind frame that can be presumed to govern private-sector investments world-wide,[1] and that such a motivation may seriously harm the political and economic interests of the host states: SWF investments may pose risks to national security, they may lead to an appropriation of technological advantages by foreign states and thus compromise the national economy's international competitiveness, or they may simply distort competition by introducing non-market rationales and repeat the unfavourable continental European experiences with state intervention over the last century.

As *Edwin M. Truman* has observed, "the growth of SWFs reflects a dramatic redistribution of international wealth from traditional industrial countries like the United States to countries that historically have not been major players in international finance and have had little or no role in shaping the practices, norms, and conventions governing the international financial system".[2] The fact that a substantial part of this new wealth is not in private hands but is in public hands has invited the suspicion that SWFs are (potential) instruments of competition between states for political and economic power – and thus are as a new version of

[1] Truman, A Blueprint for Sovereign Wealth Fund Best Practices, Peterson Institute Policy Brief No. PB08-3, April 2008, p. 3.

[2] Truman, A Blueprint for Sovereign Wealth Fund Best Practices, Peterson Institute Policy Brief No. PB08-3, April 2008, p. 3.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_4, © Springer-Verlag Berlin Heidelberg 2011

"mercantilism".[3] *Max Weber* has used the term "imperialist capitalism" to conceptualize the postmercantilist interaction of modern states in a capitalist environment.[4] In his view, capitalist interests and the political system have become closely intertwined in the modern industrial state, as imperialist capitalism offers the greatest opportunities for profit – far greater than capitalism of a pacifist kind. Increasing opportunities for profit abroad emerge as territories open up politically and economically. These opportunities are captured by the imperialist state that politically assists economic expansion of its own public and private enterprises with the aim of acquiring control of key economic sectors abroad as well as at home. The search for profit opportunities is paralleled by politically backed economic expansion as a specific form of competition among states. The imperialist impetus increasingly displaces the "pacifist" expansion based upon open markets and "freedom of trade". Viewed in this light, SWFs may be seen as the instruments of commodity-rich states who use their growing economic power to exploit the capitalist system to their political and economic benefit. Societies committed to market capitalism must respond to defend their political interests and the benefits of the economic system to which they are committed. They must not allow for a substitution of foreign-state control for home-state control of key industries as a follow-up to the broad privatization efforts of the last three decades.

Others have argued in favour of a more cautious approach. They have emphasized that the goals that SWFs pursue may be perfectly in line with the logics of markets with undistorted competition: SWFs may simply be an instrument for their owners to achieve higher rates of investment return and to diversify to reduce risk. If so, SWF investments may have the same beneficial effects as foreign investment generally: they bring liquidity to the markets and thus lower the costs of capital; moreover, they tend to flow to those projects that promise the greatest returns and thus enhance efficiency. The specific long-term investment horizon of SWFs may be particularly welcome as it can work as a stabilizing force.[5] The SWFs' investment activities during the financial crisis have tended to confirm this positive view: SWF investments have been most welcome, and several financial institutions have

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[3]See, for example, Gilson/Milhaupt, Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism, Columbia University, Law and Economics Working Paper N. 328, p. 1; Cox, The Role of Government in Markets. Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government, Oct. 24, 2007, at http://www.sec.gov/news/speech/2007/spch102407cc.htm; Foucault, *Die Geburt der Biopolitik*, p. 18, Foucault describes mercantilism as a specific organization of the production and of trade according to the principle that, first, the state is to be enriched through the accumulation of money, that, second, the state is to foster the growth of its population and that, third, the state is in an eternal state of competition with other states.

[4]Weber, *Wirtschaft und Gesellschaft*, p. 524. For an English translation see Weber, *Economy and Society*, Vol. 2, pp. 918 et seq. (Chapter IX: The Economic Foundations of 'Imperialism'); see also Mestmäcker, *Economic and Legal Foundations of Constitutional Liberty* (unpublished paper; on file with the author), for a precise summary and contextualization.

[5]See, for example, EU Commission Communication: "A common European approach to Sovereign Wealth Funds", COM(2008)115 provisional, p. 4 at 2.2.

managed to recapitalize with the help of SWFs. In Western industrialized countries, no attempts of political instrumentalization have been reported so far.

The EU Commission has been one of the most outspoken advocates of a favourable approach towards SWF investments, in line with the proposals issued by the IMF[6] and the OECD[7]: it has emphasized the EU's commitment to free movement of capital, and has called for an approach which maintains "the shared benefits of an open investment environment".[8] In return, it expects SWFs to voluntarily commit to certain minimum standards of transparency[9] and good governance[10] which shall "assuage public concerns".[11] Any more aggressive reaction would run the risk of tipping into protectionism – one of the most acute threats to a flourishing of the economy worldwide and to a rapid recovery of the international economy from the financial crisis.

The debate surrounding SWFs thus takes up the familiar question of how to deal with the states' direct engagement in markets, albeit this time with a view to non-EU states. With a view to the member states' market activities, this theme has occupied EU law for a long time. Its starting point is the neutrality of EU law vis-à-vis questions of ownership. According to Art. 295 TEC (Art. 345 TFEU), the European treaties "shall in no way prejudice the rules in Member States governing the system of property ownership". EU law has thus taken a hands-off approach to the state ownership of firms and has refrained from subjecting the member states to a duty to privatize. Instead, it has subjected public and private market actors to the same rules, including competition rules. When state entities engage in market activities, they must compete on an equal footing and must not rely on privileges vis-à-vis private firms. In addition, the member states are subject to specific rules: the free-movement rules commit the member states to the creation of an internal market characterized by the abolition of obstacles to the free movement of goods, persons, services and capital; Art. 86(1) TEC (Art. 106(1) TFEU) prohibits the member states from enacting or maintaining in force any measure contrary to the competition rules in their relation to public undertakings and undertakings to which they have granted special or exclusive rights; a regime of European state aid control is to ensure that member states will not

[6] See the proposals for a voluntary Code of Conduct for SWFs: International Working Group of Sovereign Wealth Funds (IWG), Generally Accepted Principles and Practices (GAPP) – Santiago Principles, October 2008.

[7] The OECD has identified "best practices" for SWF investments in recipient countries – see OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies, 4–5 June 2008; and the OECD Investment Committee report on recipient country policies and SWFs, approved by governments on 4 April 2008.

[8] EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 3, I.

[9] EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 10–11, IV.4.3.

[10] EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 10, VI.4.3.

[11] EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 8, IV.4.1.

distort market competition through the granting of subsidies and will not engage in subsidies wars among themselves; and public procurement rules shall constrain the broad discretion member states enjoy in their procurement decisions as they are not subject to the same competitive pressures as private actors would be.

The increased market presence of SWFs has raised the question of how to deal with the presence of *non-EU states* in European markets. Does it raise similar risks as the market presence of member states, or are the concerns fundamentally different? Does Europe need a special legal regime – an extension of the rules addressed to the member states to third-country states that want to engage in economic activities within the EU, for example an intensified regime of entry control similar to the Committee on Foreign Investment (CFIUS) review in the USA, or a regime of European golden shares? Or can we rely on the existing general legal framework to address the relevant risks, in particular on the general rules of corporate law and capital market law at the level of the member states, and on the competition rules at the level of the member states and the EU?

This paper strives to address these questions in the following order: Following a brief survey of the specific characteristics and relevance of SWFs (see Sect. SWF: The Phenomenon and the Questions It Raises) and the response that the increased economic importance of state-controlled foreign direct investment has received in the USA (see Sect. The US Reaction to Foreign States' Involvement in Economic Activities Within the USA), the paper outlines the general approach of EU law to the direct involvement of EU member states in European markets (see Sect. The Legal Framework of EU Law on Member States' Involvement in Economic Activities). The paper then asks how the presence of non-EU states in European markets can and should be addressed under EU law (see Sect. Foreign States' Involvement in Economic Activities Within the EU: What Rules Do We Have? What Rules Do We Need?). Section Conclusions concludes the paper.

SWF: The Phenomenon and the Questions It Raises

Defining SWFs

The term "sovereign wealth funds" (SWF) has become widely used to denominate state-owned investment vehicles which manage a diversified portfolio of domestic and international financial assets.[12] The first SWFs of this kind were established

[12]For this definition see EU Commission Communication: "A common European approach to Sovereign Wealth Funds", COM(2008)115 provisional, p. 3 at I; for another attempt to define SWFs see OECD, Foreign Government-Controlled Investors and Recipient Country Investment Policies: A Scoping Paper, January 2009, p. 6: SWFs are "special purpose investment funds or arrangements, owned by the general Government. Created by the general government for macro-economic purposes. SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The

in the 1950s[13] by oil-rich countries with the aim to transform present-day revenue streams into a sustainable income that would reduce the country's reliance on its finite oil resources in the long term and to ensure intergenerational equity.[14] Since then, the number and the size of SWFs have grown. The last decade in particular has seen a substantial increase in the total assets managed by SWFs,[15] which, according to general estimates, today amount to USD 1.5 trillion to USD 2.5 trillion. Despite the current financial difficulties of some SWFs, in particular Dubai World, the general prediction is that SWFs will continue to grow at a rapid pace.

A few features are common to all SWFs: they are funded and owned by a state, but are managed separately from official reserves and have no or very limited explicit liabilities in contrast, for example, to pension funds.[16] Apart from that, they are highly heterogeneous[17] and differ not only with regard to the origin of the funds managed, but also with regard to the goals pursued and their governance structure. The financial resources managed by SWFs may flow from official foreign exchange reserves, in particular where large balance-of-payments surpluses have accumulated (so-called noncommodity SWFs[18]), or – even more typically – from fiscal surpluses resulting from the export of natural resources, e. g. oil and/or gas (so-called commodity SWFs[19]).[20] The goals pursued by SWFs

SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports".

[13]The Kuwait Investment Board is generally named as the first SWF. It was set up by the Kuwait government in 1953. In 1965, it was replaced by the Kuwait Investment Office (KIO), a subsidiary of the Kuwait Investment Authority (KIA) in charge of the management of substantial parts of the Future Generation Fund today, to which the State of Kuwait allocates 10% of the country's oil revenues annually – see DB Research, Kern, Sovereign wealth funds – state investments on the rise, September 10, 2007, p. 4.

[14]DB Research, Kern, Sovereign wealth funds – state investments on the rise, September 10, 2007, p. 4.

[15]For more precise numbers see below.

[16]See, for example, EU Commission Communication: "A common European approach to Sovereign Wealth Funds", COM(2008)115, II.2.1.; Beck/Fidora, The Impact of Sovereign Wealth Funds on Global Financial Markets, ECB Occasional Paper Series No. 91 (2008), p. 6; Kimmitt, Public Footprints in Private Markets. Sovereign Wealth Funds and the World Economy, 87 Foreign Aff. (2008), pp. 119, 120.

[17]See Hammer/Kunzel/Petrova, Sovereign Wealth Funds: Current Institutional and Operational Practices, IMF Working Paper November 2008, WP/08/254.

[18]See Kimmitt, Public Footprints in Private Markets. Sovereign Wealth Funds and the World Economy, 87 Foreign Aff. (2008), pp. 119–121 (122): Noncommodity SWFs often arise from an exchange-rate intervention involving a domestic liquidity increase that has to be absorbed by issuing domestic debt to avoid unwanted inflation. Their net return depends on the difference between the yield earned on investments and the yield paid on domestic debt. The assets of this type of SWF therefore may be thought of more as borrowed money than traditional wealth. Noncommodity funds are frequently viewed critically: there is a concern that such SWFs are used as mechanisms to accumulate more foreign assets in an effort to keep the currency from appreciating.

[19]Kimmitt, Public Footprints in Private Markets. Sovereign Wealth Funds and the World Economy, 87 Foreign Aff. (2008), pp. 119 et seq. (120).

[20]See DB Research, Kern, SWFs and foreign investment policies – an update, 22 October 2008, p. 5. Other possible sources of funding include the proceeds of privatizations.

may include the intertemporal stabilization of income in highly volatile international markets for commodities,[21] the functions of a contingent pension reserve fund or a transformation of present-day revenue streams from the sale of the resources or other exports into sustainable long-term income to ensure intergenerational equity.[22] Potentially, SWFs may also pursue geostrategic and/or industrial policy goals. The relationship with the state-owner may also differ widely – some SWFs are thought to be under the direct influence and control of their government,[23] whereas others enjoy a large degree of independence in the management of the funds, aiming at a systematic, professional portfolio management. A wide variety of models exists also with a view to corporate governance structures within SWFs.[24] Finally, SWFs differ with regard to investment policies, risk management strategies and disclosure policies.[25] Although Norway's Government Pension Fund is typically cited as a role model for an independently managed, transparent SWF following well-established principles of good corporate governance[26] and acting essentially like a private investor,[27] the China Investment Corporation (CIC) remains under the overall direction of the Chinese Communist Party and state policy,[28] and its investment policy is to an important extent a reflection of the perceived political interests of China in the world. Along those lines, a recent focus of the CIC's investment activity has been the acquisition of control of natural resources abroad.[29] The overall level of transparency of most SWFs with regard to the value of asserts under management, investment objectives and

[21]See DB Research, Kern, Sovereign wealth funds – state investments on the rise, September 10, 2007, p. 4: SWFs may be a way to diversify the sources of income: they provide a liquidity pool which is replenished at times of favourable commodity prices or reserve inflows, and can be drawn upon at times when asset prices are low.

[22]DB Research, Kern, Sovereign wealth funds – state investments on the rise, September 10, 2007, p. 4.

[23]For example the China Investment Corporation (CIC) – see Backer, Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience, Transnational Law and Contemporary Problems Vol. 19 (2008), pp. 102 et seq. (250).

[24]For an empirical survey see Aizenman/Glick, Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance, NBER Working Paper Series, Paper 14562, December 2008, pp. 12 et seq.

[25]See Hammer/KunzelPetrova, Sovereign Wealth Funds: Current Institutional and Operational Practices, IMF Working Paper November 2008, WP/08/254, pp. 12–13.

[26]See http://www.norges-bank.no/templates/article____69632.aspx.

[27]See for example, Beck/Fidora, The Impact of Sovereign Wealth Funds on Global Financial Markets, ECB Occasional Paper Series No. 91 (2008), p. 10.

[28]Backer, Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience, Transnational Law and Contemporary Problems Vol. 19 (2008), pp. 102 et seq. (250 et seq.).

[29]Backer, Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience, Transnational Law and Contemporary Problems Vol. 19 (2008), pp. 102 et seq. (262 et seq.).

strategies, target portfolio allocations, risk management systems and internal controls has so far remained low.[30]

Experiences with SWFs So Far

With a view to the total assets under SWF management, SWFs are considered a source of investment of "systemic importance" today.[31] Although the amount of USD 1.5 trillion to USD 2.5 trillion may appear small compared with a global equity market capitalization of USD 50 trillion, the assets managed by all SWFs roughly equal the combined assets of all hedge funds and private equity firms. A politicized management of a significant portion of SWFs could inflict serious harm not only upon the targeted companies, but also upon the world economy as a whole. At the same time, ownership of the wealth under SWF management is relatively concentrated. The top ten SWFs manage significantly more than USD 100 billion each, and together represent 85% of all sovereign assets.[32] Almost half of all sovereign assets are held by SWFs from the Middle East.[33] SWFs from the Asian region follow (29%). SWFs from Russia and Norway manage around 16% of all sovereign assets.[34] The Abu Dhabi Investment Authority (ADIA), with an estimated USD 875 billion USD under management, the Norges Bank Investment Management (NBIM), with an investment volume of around USD 400 billion, the Government of Singapore Investment Corporation (GIC), managing an estimated USD 330 billion, the Kuwait Investment Authority (KIA), with an estimated investment volume of USD 213 billion, and the CIC, which – although established only in 2007[35] – already manages an estimated USD 200 billion,[36] are among the largest single SWFs.[37]

Although these figures are impressive, it is generally acknowledged that there have been no indications of an abuse or politicized management of SWFs in Western industrialized countries so far. Generally, the investments of SWFs appear

[30]See Beck/Fidora, The Impact of Sovereign Wealth Funds on Global Financial Markets, ECB Occasional Paper Series No. 91 (2008), p. 5 et. seq.

[31]EU Commission Communication: "A common European approach to Sovereign Wealth Funds", COM(2008)115 provisional, p. 3 at I.

[32]DB Research, Kern, SWFs and foreign investment policies – an update, 22 October 2008, p. 4

[33]DB Research, Kern, SWFs and foreign investment policies – an update, 22 October 2008, p. 4.

[34]DB Research, Kern, SWFs and foreign investment policies – an update, 22 October 2008, p. 4.

[35]The CIC, equipped with an initial endowment of USD 200 billion, replaced China Central Huijn Investment Corporation, which had been established in 2003.

[36]For a more thorough discussion of the CIC see Backer, Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience, Transnational Law and Contemporary Problems Vol. 19 (2008), pp. 102 et seq. (243 et seq.).

[37]For a brief overview of some important SWFs see for example, Beck/Fidora, The Impact of Sovereign Wealth Funds on Global Financial Markets, ECB Occasional Paper Series No. 91 (2008), p. 9.

to be relatively diversified across industry sectors.[38] In 2007–2008, SWFs invested heavily in the US and EU financial sector,[39] apparently attracted by low share prices and the perception of a strategic opportunity.[40] They were perceived as highly welcome investors during this period of turmoil, and although the transactions have included large-scale investments in single firms, their commitment has contributed to their perception as responsible market participants. In Germany, SWF investments in the car industry[41] have received high publicity recently. Investments in defence-related companies or firms active in the field of security-relevant technologies, on the other hand, have been extremely rare.[42]

Frequently, SWFs have been rather passive investors in the past, and have acquired small to medium stakes in the relevant target firms, refraining from claiming board seats or attempts to influence the business strategies or the day-to-day business of the companies. The Norwegian NBIM, for example, has committed to a policy of not acquiring stakes exceeding 10%. Most shareholdings are below 2%. Such a policy is, however, not pursued by all SWFs. Some SWFs have opted for an active involvement and have acquired controlling stakes up to 100% of the votes.[43] Recent SWF investments in the financial industry have generally followed an intermediate pattern: the stakes acquired have been minority stakes, but of a significant size[44] – frequently just below 10%.[45]

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[38]They go into the real estate and construction sector, the commodities and energy sector, the technology industries and into infrastructure and transportation – see DB Research, Kern, SWFs and foreign investment policies – an update, 22 October 2008, p. 8.

[39]DB Research, Kern, SWFs and foreign investment policies – an update, 22 October 2008, p. 7 et seq. See also Beck/Fidora, The Impact of Sovereign Wealth Funds on Global Financial Markets, ECB Occasional Paper Series No. 91 (2008), pp. 11–12; Sun/Hesse, Sovereign Wealth Funds and Financial Stability – An Event Study Analysis, October 2009, IMF Working Paper WP/09/239, pp. 3–4: SWFs have contributed more than USD 50 billion of capital to financial institutions since November 2007.

[40]DB Research, Kern, SWFs and foreign investment policies – an update, 22 October 2008, p. 10.

[41]See in particular, Qatar's investment in VW/Porsche – "Einstieg von Katar in VW ist perfekt", Spiegel Online, 14 August 2009.

[42]An exception is the investment of Dubai International Capital's in the EU-based EADS in 2007. Dubai International Capital acquired a share of 3.12%.

[43]According to DB Research, Kern, Staatsfonds – Staatliche Investitionen in der Finanzkrise, July 2009, p. 23, 62% of all acquisitions publicly known have led to stakes of 20% or more in the target firm. Twenty-five percent of all investments have led to the acquisition of 100%.

[44]For example, China, through the CIC, has acquired a 9.9% stake in the Blackstone Group, and a 9.9% stake in Morgan Stanley. Singapore, through GIC and Temasek, has, inter alia, acquired a 9.9% stake in Merrill Lynch, an 18% stake in the UK-based Standard Chartered Bank Ltd. and a 9% stake in UBS. Dubai, through DFG, DIFC, DIFX and other funds has, inter alia, acquired a 28% stake in the London Stock Exchange, a 20% stake in Nasdaq and a 28.4% stake in OMX. Qatar, through QIA, has acquired, inter alia, an 8.9% stake in Barclays Bank, a 24% stake in the London Stock Exchange and a 10% stake in OMX. With such stakes, the SWFs have in some cases become the largest single shareholders in the targeted financial institutions and will – individually and/or together – have an important position in these high-profile companies in the future.

[45]In many jurisdictions, the 10% threshold triggers special regulatory oversight. In the USA, for example, the acquisition of a stake of 10% or more will allow the foreign investment control

Concerns Regarding the Investment Activities of SWFs and Other Foreign State-Controlled Entities

The recent investments by which SWFs have acquired significant shareholdings such as to grant them considerable influence over, or even control of, the target companies have fuelled concerns that the occurrence of abuses will only be a matter of time. The notable absence of negative experiences does, however, indicate a certain imbalance of the debate: although SWFs have generally been good corporate citizens so far, acquisition sprees by state-owned enterprises (SOEs) have indeed raised the spectre of "imperialist capitalism" at times. In fact, all incidences of state-controlled foreign direct investment which have raised public concerns have involved SOEs. This is, for example, true for the bid by China National Offshore Oil Corporation (CNOOC) – 70% owned by the Chinese government – for the US-based Unocal Oil Company in July 2005 (a bid which was eventually withdrawn),[46] or the plan by Dubai Ports World (DP World) – a company owned by the government of Dubai – to acquire the London-based Peninsular and Oriental Steam Navigation Company (P&O), the fourth largest ports operator in the world, running, *inter alia*, major port facilities in New York, New Jersey, Philadelphia, Baltimore, New Orleans and Miami, a plan which ultimately failed owing to political resistance in the USA.[47] Similarly, attempts by Gazprom to integrate vertically into the energy sector of neighbouring states have raised concerns. In Germany, some discussion has ensued on an allegedly politically driven investment by the Russian investor Yusufov in the failing shipyard industry in Mecklenburg–West Pomerania.[48]

National legislation on foreign investment control has generally recognized that risks to public policy or national security are not specific to investments by SWFs. Foreign investment control regimes typically extend to all foreign acquisitions of substantial shareholdings indiscriminately of the identity of the acquirer. This paper shall focus on the specific risks that may result from cross-border investments by foreign government-controlled investment vehicles, in particular SWFs and SOEs.

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regime to kick in. Moreover, the acquisition of shares in banks from 10% upwards need separate approval by the SEC, and the investor will obtain the status of a bank holding company and become subject to specific supervision.

[46]For a discussion of this case see Casselman, China's Latest 'Threat' to the United States: The Failed CNOOC-Unocal Merger and Its Implications for Exon-Florio and CFIUS, Ind. Int'l & Comp. L. Rev. 17 (2007), pp. 155 et seq.

[47]For a discussion of this case see Mostaghel, Dubai Ports World Under Exon-Florio: A Threat to National Security or a Tempest in a Seaport?, Alb. L. Rev. 70 (2007), p. 583.

[48]See, for example, Graupner, German shipyard creditors clear the decks for new Russian buyer, DW-World, 18 August 2009.

The US Reaction to Foreign States' Involvement in Economic Activities Within the USA[49]

In the USA, a national security review of foreign acquisitions of US companies has been in place for some time now. The CFIUS, established in 1975 by President Gerald Ford as an interagency committee within the executive branch and chaired by the Department of Treasury, was originally designed as a mere monitoring body: it was to monitor the impact of inbound foreign investment and coordinate US investment policy. It was transformed into a system of formal review of foreign acquisitions of control of US firms through the 1988 Exon–Florio amendment[50] to the Defense Production Act of 1950, passed in reaction to growing political concerns about the increase of foreign direct investments in the USA, in particular originating in Japan and the UK. The Exon–Florio amendment for the first time formally empowered the president to suspend or prohibit acquisitions that could result in foreign control of US companies if the transaction threatened to impair national security.[51] The president delegated the review of individual transactions to the CFIUS, which was later statutorily established by the Foreign Investment and National Security Act (FINSA) of 2007. With the so-called Byrd Amendment of 1992,[52] CFIUS review became mandatory for all transactions where the acquirer is "controlled by or acting on behalf of a foreign government".

Despite the rather comprehensive regime of control already in place, the 2005 bid by CNOOC for Unocal and the plans by DP World to acquire P&O led to debates about the need to improve a previously lenient and allegedly ineffective investment control regime. In 2007, the FINSA[53] was passed to amend the Exon–Florio Act, and has further been specified by an Implementing Executive Order of 23 January 2008.[54] The FINSA has once more extended the range of transactions falling under the CFIUS review. According to Sec. 751(d) Defense Production Act in its current version, any merger, acquisition or takeover is subject to review if:

[49]For a description and discussion of the US regime of foreign investment control see, for example, Georgiev, The Reformed CFIUS Regulatory Framework: Mediating Between Continued Openness to Foreign Investment and National Security, Yale Journal on Regulation 25 (2008), pp. 125 et seq.; Prabhakar, Deal-Breakers: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms, 2009, available at http://www.ssrn.com.

[50]Omnibus Trade and Competitiveness Act of 1988 § 5021, Pub. L. No. 100-418, 102 Stat. 1107 (1988) (codified at 50 U.S.C. App. § 2170).

[51]Prior to the Exon–Florio Amendment, foreign acquisitions could be blocked only if the president declared a national emergency or regulators found a violation of federal antitrust, environmental or securities laws.

[52]National Defense Authorization Act for Fiscal Year 1993, Pub. L. No. 102-484 § 837, 106 Stat. 2315, 2463–65 (1992) (codified at 50 U.S.C. app. § 2170(b)(2000)).

[53]Pub.L. No. 110–49 (2007).

[54]E.O. 13456.

> . . . (1) there is a credible evidence that foreign entity exercising control might take action that threatens national security, and (2) the provisions of law other than the International Emergency Economics Powers Act do not provide adequate and appropriate authority to protect the national security.

The term “national security” has deliberately been left undefined, in order not to curtail “the President’s broad authority to protect the national security”.[55] Some guidance is offered as to the factors that are considered in the security analysis. They include control of security-relevant technologies, relevance for national defence and, since the entry into force of FINSA, also transactions involving critical infrastructure and energy assets. These factors are not conclusive, however. Generally, the term “national security” is to be interpreted broadly and without limitation to particular industries.[56] According to one observer, the scenarios which CFIUS considers most worrisome in practice are the threat of a shutdown of critical facilities, of the removal of sensitive data offshore, of a denial of access to critical technology to the US government, of the transfer of US-developed technology overseas, of participation in espionage in government activities and of aiding enemies of the USA.[57] The fact that the acquirer was owned or controlled by a foreign state has repeatedly influenced the outcome of a CFIUS review in the light of these concerns.[58]

The CFIUS review procedure is a two-step procedure. In a first step, the committee decides in the course of a 30-day review whether a control proceeding is to be initiated. In practice, this is relatively rare. If a control procedure is initiated, the parties to the transaction will frequently withdraw the planned acquisition voluntarily.[59] Where the investors hold on to their plan, the control procedure itself will take place. It has to be completed within a maximum of 45 days. A specificity of the CFIUS review procedure is that no mandatory notification requirement exists. A CFIUS review begins either with a voluntary notice from a party to a planned transaction or on recommendation from a CFIUS member agency that believes that a transaction might affect US national security. In practice, parties tend to notify voluntarily, however, as in the absence of a notification, they would remain indefinitely subject to the CFIUS review and potential remedial actions by the president. Any voluntary filing, on the other hand, will provide the parties with a

[55]See the Regulations Pertaining to the Mergers, Acquisitions, and Takeovers by Foreign Persons.

[56]Regulations Pertaining to the Mergers, Acquisitions, and Takeovers by Foreign Persons.

[57]Prabhakar, Deal-Breakers: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms, 2009, p. 15, available at ssrn.com.

[58]For this hypothesis see: Prabhakar, Deal-Breakers: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms, 2009, available at ssrn.com.

[59]According to a study conducted by Georgiev, The Reformed CFIUS Regulatory Framework: Mediating Between Continued Openness to Foreign Investment and National Security, Yale Journal on Regulation 25 (2008), pp. 125 et seq., the USA initiated 25 control proceedings between 1988 and 2005. In 13 of these proceedings, the investor retreated from an acquisition in response, without awaiting the result of the control procedure.

regulatory safe harbour, immunizing them against subsequent reviews or actions except in cases where the parties have misrepresented their plans.

Although the procedure itself is relatively formalized and transparent,[60] the political nature of the proceeding is apparent not only from the broad and open nature of the substantive test, but also from the composition of the CFIUS, which brings together 12 branches of the administration, among them finance, justice, economy and defence. The Department of Treasury has remained the lead agency. The CFIUS enjoys broad discretion both in the identification of a risk and in the imposition of remedies: if national security interests are negatively affected, and laws other than Exon–Florio and the International Emergency Economic Powers Act[61] do not provide adequate and appropriate authority to protect national security, the acquisition can be prohibited, or mitigation measures may be imposed. FINSA empowers CFIUS to reopen a reviewed transaction if mitigation measures are materially breached. Upon completion of a review or investigation, CFIUS must provide written notice to Congress – in addition to a report which must be submitted annually.

In practice, foreign investment control has generally been handled cautiously in the USA. During 2006 and 2007, for example, only 13 transactions were subjected to a 45-day investigation, and none of them were prohibited.[62] It is, however, widely believed that the CFIUS review has a further-reaching deterrent effect. Transactions which might become politically sensitive are abandoned before the CFIUS review kicks in.[63]

From a European perspective, the broad, open-ended nature of the review criteria and the political discretion in their interpretation and application is notable. A review regime of this kind may allow an effective response to any perceived act of “imperialistic capitalism” or other threats to national security. But it runs the risk of becoming politicized and protectionist itself.[64] Although overinclusive in some respects, the CFIUS review is underinclusive in others: risks to national security

[60]See in particular the Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 31 CFR Part 800, which entered into force on 21 March 2008.

[61]This act allows the president to declare a national emergency to deal with extraordinary threats to national security or the economy, 50 U.S.C. §§ 1701–1706.

[62]US Government Accountability Office (GAO), Foreign Investment: Laws and Policies Regulating Foreign Investment in 10 Countries, GAO-08-320, Feb. 2008, p. 6; see also Georgiev, The Reformed CFIUS Regulatory Framework: Mediating Between Continued Openness to Foreign Investment and National Security, Yale Journal on Regulation 25 (2008), pp. 125 et seq. (129).

[63]See Prabhakar, Deal-Breakers: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms, 2009, p. 10 of the manuscript, available at ssrn.com.

[64]See Georgiev, The Reformed CFIUS Regulatory Framework: Mediating Between Continued Openness to Foreign Investment and National Security, Yale Journal on Regulation 25 (2008), pp. 125 et seq. (130 et seq.); Prabhakar, Deal-Breaker: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms, 2009, in particular p. 15 of the manuscript: “‘CFIUS’ vulnerability to congressional pressure and lobbying is largely a function of its own statutory vagueness. . . .”, available at ssrn.com.

which would result from a later shift of policy of a state controlling an SWF or SOE cannot be captured by a regime which is essentially a regime of ex ante control.

The Legal Framework of EU Law on Member States' Involvement in Economic Activities

If the handling of the US regime of foreign investment control is thus prone to fall into the spiral of a politically popular protectionism,[65] the EU has reacted to similar dangers by replacing the logics of politics with the rule of law – at least as far as the relations between the member states are concerned. Any national foreign investment entry control regime which potentially hinders cross-border investment from other member states will be subject to review under the free-movement rules, in particular the free movement of capital (Art. 56 TEC equivalent to Art. 63 TFEU) and freedom of establishment (Art. 43 TEC equivalent to Art. 49 TFEU). In light of the principle of neutrality vis-à-vis public or private ownership as derived from Art. 295 TEC (equivalent to Art. 345 TFEU), this is true irrespective of whether the foreign investor is privately owned or whether it is owned or controlled by another member state. EU law subjects private and public undertakings to the same rules and constraints; in return they enjoy the same rights.

Do Public Undertakings Benefit from the Protection of the Free-Movement Rules?

Recently, some doubts have been raised in this regard, albeit only implicitly. Among others, *AG Maduro* has suggested the existence of a fundamental difference in the conduct of private and public undertakings – a difference which could become legally relevant under the free-movement rules. In his recent opinion in *Federconsumatori, Maduro* inquires whether the public ownership of shares itself can constitute a restriction of the free movement of capital, i.e. whether it is liable to dissuade investments from other member states (para. 23). Finding that "[t]he mere fact that a public body owns shares in a company does not reduce the attractiveness of cross-border investments in that company, as long as investors in other Member States can be sure that the public body concerned will, with a view to maximising its return on investment, respect the normal rules of operation of the market" (para. 25), he simultaneously suggests that "[. . .] as public bodies are subject to local or national mechanisms of political accountability, they are naturally inclined to adjust their conduct in light of the interests of those who are represented within the

[65] See, for example, Prabhakar, Deal-Breaker: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms, 2009, available at ssrn.com.

framework of those mechanisms. Therefore, when a public body holds shares which give it a privileged position in relation to other shareholders as regards its powers of control in the company concerned, there is a real risk that those powers will be used to grant selective and potentially discriminatory access to the national market" (para. 25). The case did not require Maduro to take his theory to its logical limits. Taken seriously, Maduro's argument would call into question the EC Treaty's well-established principle of neutrality vis-à-vis public versus private ownership. If states are generally suspected of exercising their ownership rights on the basis of a political rather than a market logic, general legal constraints imposed on cross-border investments by entities owned or controlled by another member state might be justified. This view is reflected in a public opinion which – in a mix of legitimate fear of "imperialist capitalism" and national protectionist sentiments – views the cross-border ambitions of EDF, GDF and similar state-owned firms with intense scepticism.

Irrespective of an empirical verification of the claim that public and private undertakings behave differently by their nature, EU law has refused to adopt this distinction, which would have questioned the existence of public undertakings in and of itself. Instead, EU law subjects the interactions between member states and public as well as private undertakings to a specific set of legal rules which shall ensure a level playing field. Such rules include, in particular, the state aid rules, the prohibition of member states to enact or maintain in force any measure contrary to the competition rules in their relation to public undertakings and undertakings to which they have granted special or exclusive rights (Art. 86(1) with Art. 81, 82 TEC equivalent to Art. 106(1) with Art. 101, 102 TFEU), the competition rules which apply equally to private and public market actors, and the public procurement rules. Although these rules may not have erased the difference that exists in the fundamental motivations of private and public ownership, they have imposed a tight corset upon public undertakings, subjected them to the rules of the market and competition and have largely contained the risks of a chain of "imperialist capitalist" actions and protectionist responses. It is in this logic that EU member states which implement a foreign investment entry control procedure have to justify the restrictions of the freedom of establishment and of the free movement of capital, irrespective of whether investors from other member states are state-owned or state-controlled. Public undertakings, like private undertakings, benefit from the protection of the free-movement rules.

Cross-Border Investments: Freedom of Establishment or Free Movement of Capital?

In the EU, most member states have abandoned foreign investment entry control for investments originating in other member states. Only in a very narrow set of cases will investments from other member states be subject to an authorization regime,

namely where they involve the acquisition of control or substantial shareholdings in companies is involved which produce military equipment, create cryptographic systems admitted for the transmission of governmental classified information or deal with nuclear technologies. Since such transactions may compromise the vital security interests of a member state, the restrictions implicit in an authorization regime are justified, regardless of whether they are assessed under the rules on freedom of establishment (Art. 43 TEC equivalent to Art. 49 TFEU) or under the free movement of capital rules (Art. 56 TEC equivalent to Art. 63 TFEU).

A few member states have maintained broader regimes of foreign investment control vis-à-vis investments originating from other member states. French law, for example, for a long time required prior authorization by the French Ministry of the Economy for every direct foreign investment which is "such as to represent a threat to public policy [and] public security". The European Court of Justice (ECJ) reviewed this regime in *Eglise de Scientologie*[66] and found it to be incompatible with Art. 56 TEC (equivalent to Art. 63 TFEU). It accepted that, with a view to the difficulty in identifying and blocking capital once it has entered a member state, a prior authorization scheme for foreign direct investment may, in principle, be justifiable, since a (less restrictive) prior declaration regime might be inadequate to counter a serious threat to public policy and public security. However, the French system was contrary to the principle of legal certainty: it failed to give any indication to investors as to the specific circumstances in which prior authorization would be required and in which a serious threat to public policy and public security might be found to exist (paras. 19–23).

In *Eglise de Scientologie*,[67] the foreign investment control regime was assessed against the guarantee of free movement of capital (Art. 56 TEC equivalent to Art. 63 TFEU). Freedom of establishment – the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms, under the laws of the host member state (Art. 43(2) TEC equivalent to Art. 49(2) TFEU) – was not mentioned as a legal reference point. The approach chosen by the ECJ is explained by the structure of the French foreign investment control regime which was to be reviewed: it did not only address the acquisition of control or a stake conferring substantial influence in a French undertaking, i.e. such foreign investments which fall within the scope of Art. 43 TEC (equivalent to Art. 49 TFEU),[68] but it also potentially extended to mere portfolio investments which are outside its scope. National investment control regimes which are more narrowly construed and apply only to such cross-border investments which "serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which the capital is made available in order to carry out an

[66]ECJ Case C-54/99, *Eglise de Scientologie*, [2000] ECR I-1335.

[67]ECJ Case C-54/99, *Eglise de Scientologie*, [2000] ECR I-1335.

[68]Art. 43 EC protects those cross-border investments which "serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which the capital is made available in order to carry out an economic activity" (frequently called "direct investment"). It does not protect mere portfolio investments.

economic activity", i.e. to the acquisition of control or a substantial stake below the level of control, will potentially be assessed both under Art. 43 TEC (equivalent to Art. 49 TFEU) and under Art. 56 TEC (Art. 63 TFEU).

Foreign States' Involvement in Economic Activities Within the EU: What Rules Do We Have? What Rules Do We Need?

Concerns Regarding the Involvement of Foreign States in Economic Activities Within the EU: The Commission's Proposal for a "Common European Approach to Sovereign Wealth Funds"

Compared with the densely-knit European legal framework regulating the member states' interventions in markets such as to ensure a "level playing field" whenever the member states themselves engage in economic activities, the absence of rules binding foreign states engaged in economic activities within the EU is striking at first sight. Despite the absence of constraints imposed on the market activities of foreign states matching those to which the EU member states are subject, Art. 56(1) TEC's (equivalent to Art. 63(1) TFEU's) scope of protection has been unconditionally extended to third-country investors, including entities owned or controlled by third-country states.

For some time, the EU Commission itself seemed to be divided on the question whether a specific European regime of entry control or behavioural control vis-à-vis third-country state-controlled investors would be needed to balance the absence of legal constraints on the interaction between these investors and their home states. The proposal to introduce an EU committee on foreign investment that should mirror the CFIUS review in the USA was ultimately rejected, however, as was the proposal to introduce some kind of "European golden share" mechanism to monitor "suspicious" non-EU foreign investment.[69] In its communication entitled "A common European approach to Sovereign Wealth Funds" of 2008,[70] the Commission rather adopted a non-interventionist soft-law approach closely aligned with the approach favoured by the IMF[71] and the OECD.[72] SWFs are advised to base their

[69] EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 8, at IV.4.1.

[70] EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional.

[71] See in particular the so-called "Santiago principles" – the "Generally Accepted Principles and Practices" on Sovereign Wealth Funds issued in Oct. 2008 by the International Working Group of Sovereign Wealth Funds in cooperation with the IMF. The "Santiago Principles" are meant to serve as a voluntary code of conduct for SWFs and for their owners.

[72] See OECD, Guidance on recipient country policies towards SWFs, adopted by OECD members on 8 October 2008.

investment decisions strictly on economic objectives and to compete on fair terms with private-sector investors.[73] Moreover, SWFs are requested to follow certain principles of "good governance" and transparency to build confidence vis-à-vis recipient states. The principles of good governance shall include[74]:

- A clear allocation and separation of responsibilities in the internal governance structure of an SWF
- An investment policy that clearly defines the overall objectives to be pursued by the SWF
- Operational autonomy for the SWF in achieving these objectives
- Public disclosure of the general principles governing an SWF's relationship with the governmental authority
- The disclosure of the general principles of internal governance that provide assurances of integrity
- And a fully developed risk-management policy

In addition, SWFs should disclose investment positions and asset allocations annually, in particular investments for which there is majority ownership; they should disclose the exercise of ownership rights; the use of leverage and of the currency composition; the size and source of their resources; and their home country regulations and oversight.[75] Such transparency is meant to provide for increased accountability and a disciplinary effect on the management of SWFs.[76] Finally, the Commission considers an extension of the 2001 IMF Guidelines for Foreign Exchange Reserve Management[77] to SWFs.[78]

The Commission's approach must be valued for the political effort it makes to discourage protectionist responses to SWFs – or, for that matter, to SOEs – to maintain an open investment environment in Europe and to cooperate at an international level in the search for an adequate response. At the same time, the effectiveness of the measures proposed may be questioned – provided that the investment activities of SWFs and third-country SOEs do raise real concerns: The actual compliance with principles of "good governance" will be almost impossible to monitor. Moreover, a commitment to a voluntary code of conduct may be abandoned by an SWF-owning country any time, with no legal consequences attached. Reliance on the self-enforcing character of such commitments due to

[73]EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 5 at 2.3.

[74]EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 10.

[75]EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 11.

[76]EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 10.

[77]http://www.imf.org/external/np/mae/ferm/eng/index.html.

[78]EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 10.

the shared interests of all SWFs in the maintenance of an open international investment environment may underestimate the force of the political dynamics in some SWF-owning states. Commitments to transparency, on the other hand, would not address the real problem,[79] even if they were made binding. Transparency will tend to strengthen the self-enforcing character of codes of conduct as long as SWFs and their sponsoring countries feel committed to these codes generally. They will likely fail to hinder politically motivated investment strategies by SWFs where the sponsoring countries would decide in favour of such a path.

In one area – namely in the energy sector – the Commission has opted for a significantly more restrictive approach. Both Art. 11 of Directive 2009/72/EC concerning common rules for the internal market in electricity[80] and Art. 11 of Directive 2009/73/EC concerning common rules for the internal market in natural gas[81] provide that if a transmission system owner or operator which is controlled by a person or persons from a third country or third countries requests a certification as an approved and designated transmission system operator in one of the member states, a special control procedure shall be conducted by the competent national regulatory authority in close cooperation with the EU Commission. The certification shall be refused if the applicant does not demonstrate that the unbundling requirements set out in Art. 9 of the directive are complied with, and that a certification would not put at risk the security of energy supply of the member state and the Community. In taking its decision, the national regulatory authority shall take "utmost account" of the opinion of the Commission, which it is obliged to request before deciding itself. Interestingly, it is not for the national regulatory authority to prove that a risk to the security of energy supply positively exists; rather, any remaining doubts will go against the third-country applicant.[82]

The recitals accompanying both directives set out the rationale underlying these rules. They acknowledge that security of supply is essential for public security, for the competitiveness of the economy and for the well-being of the EU citizens, and that it is inherently connected to the efficient functioning of the internal market in energy. Persons from third countries should therefore be allowed to control a transmission system or a transmission system operator only if they comply with the unbundling requirements that apply inside the EU. Moreover, the high importance of security of supply of energy to the EU would justify special measures to protect public order and public security. The case-by-case assessment which is to be performed shall take into account in particular the independence of network operation, the level of the Community's and individual member states' dependence on energy supply from third countries, and the treatment of both domestic and foreign

[79]See also Gilson/Milhaupt, Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Merchantilism, available at ssrn.com, p. 19.

[80]Directive 2009/72/EC of 13 July 2009, OJ 2009 L 211/55.

[81]Directive 2009/73/EC of 13 July 2009, OJ 2009 L 211/94.

[82]See also Reinisch, Protection of or Protection Against Foreign Investment? The Proposed Unbundling Rules of the EC Draft Energy Directives, EYIEL 1 (2010), p. 53.

trade and investment in energy in a particular third country, but also the rights and obligations arising under international law, in particular the international agreements between the EU and the third country concerned.[83] In the area of energy, the EU rules thus appear to acknowledge that an important difference may exist between EU and non-EU investors, as both are not subject to the same set of rules. No special reference is made to the question whether a non-EU investor is privately owned or state-controlled, but a potential link between this question and the assessment criteria to be applied is difficult to deny.

Member States' Entry Controls for Foreign Investment and the Free Movement of Capital

The EU Commission's communication highlights that its proposals are meant to complement the member states' prerogatives and existing powers to protect legitimate public policy objectives and interests.[84] In particular, it refers to the member states' powers under Art. 58 TEC/Art. 65 TFEU to restrain the free movement of capital to the extent necessary and proportionate to the member states' legitimate public policy goals and national security interests. The Commission has refrained from taking a clear position on what national measures may be justified under Art. 58 TEC/Art. 65 TFEU.

The member states' legal regimes put in place to address the risks associated with foreign investment differ significantly. Most member states provide for a possibility of foreign investment entry control, but whereas some member states limit such restrictive regimes to investments in the defence and military equipment industries and other directly security-relevant industries, others extend the control procedure beyond this core. Differences exist also with a view to how precisely the public interests to be protected are defined. Frequently, the reach of foreign investment control procedures is broad and the assessment criteria leave substantial room for political discretion.[85]

France, for example, is traditionally known for a relatively rigid foreign investment control. According to the French Monetary and Financial Code, financial dealings between France and foreign countries are, in principle, unrestricted (Art. L 151-1). However, the French government may make certain foreign exchange transactions, including mergers, acquisitions and other types of foreign investment,

[83]See recital 25 of Directive 2009/72/EC of 13 July 2009, OJ 2009 L 211/55 and recital 22 of Directive 2009/73/EC of 13 July 2009, OJ 2009 L 211/94.

[84]EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 11, V.

[85]The claim that common law systems generally tend to be less specific and less detailed than laws and policies of countries that operate under a civil law system (for this claim see US Government Accountability Office (GAO), Foreign Investment: Laws and Policies Regulating Foreign Investment in 10 Countries, GAO-08-320, Feb. 2008, p. 9) is not born out by the evidence.

subject to a notification requirement and a prior approval by the French government, not only if they concern companies engaged in research, production or sales of arms, munitions, powder or explosive substances, but also if the target companies participate, even occasionally, in the exercise of public authority or if they are engaged in activities such as might endanger public order, public safety or the interests of national defence (Art. L 151-2). In reaction to the ECJ's judgment in *Eglise de Scientologie*,[86] France issued Decree No. 2005-1739 of 30 December 2005, which now specifies 11 "sensitive" sectors where foreign investment may raise such risks.[87] In some industries, a national security review will be performed only if the acquirer is a non-EU investor; in other industries the review will extend to EU-based investors as well.[88] The control procedure, which will kick in if there is an acquisition of control of a firm with its headquarters in France, the acquisition of a branch of a firm with corporate headquarters in France or the acquisition of more than one third of the capital or voting rights of a firm with its headquarters in France,[89] is led by the Ministry of the Economy, Finance and Employment, with additional input from other ministries, in particular the Ministry of Defence. If the government finds that an investment jeopardizes public order, public safety or national defence interests, it may prohibit the relevant transactions, or it may authorize them with conditions attached.[90] Particular attention is given to the preservation of industrial capacities (R&D, know-how, other intellectual property assets or production capacity) on French territory, the assurance of continuity of supplies and compliance with existing contractual commitments (e.g. public

[86]ECJ Case C-54/99, *Eglise de Scientologie*, [2000] ECR I-1335.

[87]Decree No. 2005-1739 now lists 11 sectors which are thought to be particularly sensitive with regard to national security. These sectors include (1) gambling and casinos, (2) private security, (3) research, development, or production of means to stem the unlawful use, in terrorist activities, of pathogens or toxins, (4) equipment designed to intercept correspondence and monitor conversations, (5) testing and certification of the security of information technology products and systems, (6) production of goods or supply of services to ensure the security of the information systems, (7) dual-use items and technologies – a potentially broad category, (8) cryptology equipment and services, (9) activities carried out by firms entrusted with national defence secrets, in particular under the terms of national defence contracts or of security clauses, (10) research, production, or trade in weapons, ammunition, powders, and explosives intended for military purposes or war materials and (11) activities carried out by firms holding a contract for the design or supply of equipment for the Ministry of Defence, either directly or as subcontractors, to produce an item or supply a service for one of the sectors listed in nos. 7–10.

[88]A limited number of exceptions exist to the notification and prior authorization requirement, e.g. creation of a branch, extension of an existing business and increases in participation if the investor already holds more than 66.65%.

[89]For the definition of the term "control" see Art. L 233-3 of the French Commercial Code.

[90]In practice, conditions have been imposed on foreign direct investment transactions repeatedly. An example is the acquisition of the Saft batteries business of the French company Alcatel by a pan-European group of investment funds in 2004. The French government imposed stringent conditions on the grounds that certain batteries are used for defense purposes. Among the conditions was the requirement that the Saft headquarters remain in France, along with all research centres and production facilities serving French military purchasers.

procurement contracts). The fact that the investor is a foreign SOE or an SWF can be considered during the review process, although no specific rules or guidelines exist in this regard. A specificity of the French regime is that the notification requirement and the prior authorization scheme kick in at various occasions: not only at the time when the initial investment is made, but also during any recapitalization, change in the shareholding or upon a resale of the investment. Continuous oversight is thus ensured. Any negative decision can be appealed to the French administrative courts.

Germany, by contrast, has long had a reputation for a particularly liberal foreign investment regime. A specific foreign investment control for public security-related investments was introduced into the German Foreign Trade and Payments Act (Außenwirtschaftsgesetz – AWG) only in 2004 in reaction to concerns whether the German export control laws were sufficient to protect national security interests in the case of a foreign acquisition of a directly security relevant German company. The possibility for intervention was, however, narrowly construed. The relevant parts of § 7 AWG read:

> Protection of Security and External Interests:
>
> (1) Legal transactions and acts in foreign trade and payments may be restricted in order to
> 1. guarantee the vital security interests of the Federal Republic of Germany.
> 2. prevent a disturbance of the peaceful coexistence between the nations, or
> 3. prevent a major disruption of the foreign relations of the Federal Republic of Germany.
>
> (2) According to paragraph 1 above, the following may be restricted in particular [...] legal transactions on the purchase of resident companies which
> – produce or develop war weapons and other military equipment, or
> – produce cryptographic systems admitted for the transmission of governmental classified information by the Federal Office for Information Security Technology with the company's approval, or legal transactions on the acquisition of shares in such companies, in order to guarantee the vital security interests of the Federal Republic of Germany; this applies in particular if the political and security interests of the Federal Republic of Germany or the military security precautions are jeopardized as a result of the purchase.
>
> [...]

For transactions of the kind covered by § 7 AWG, a mandatory notification scheme was introduced: foreign acquisitions of a German firm active in the production of weapons and other military equipment or cryptographic systems, or acquisitions of stakes of 25% of the voting rights or more, must be reported to the German government. The notification will trigger a control procedure which must be completed within 1 month and ends with either an approval or with a prohibition.

In reaction to a broad public debate on SWFs in Germany, this originally narrow foreign investment control regime has recently been extended. On the basis of a 2009 amendment of the AWG,[91] the Federal Minster of Economics and Technology is now empowered to subject any acquisition of a stake of 25% or more of any

[91]Dreizehntes Gesetz zur Änderung des Außenwirtschaftsgesetzes und der Außenwirt schaftsverordnung, BGBl. I Nr. 20 of 23 April 2009, p. 770. The new law entered into force on 24 April 2009;

listed or non-listed German firm[92] by a non-EU investor to a control procedure case by case (§ 53 AWG). The stated goal of such a control procedure is to inquire whether the acquisition will endanger the public order or security of Germany. According to § 7(2) No. 6 AWG, the public order or security shall be considered to be in danger only if a real and sufficiently severe danger can be identified which affects a fundamental interest of society.[93] The kind of threat that could lead to a prohibition of the investment or any other type of restraint is not specified. Although the main aim of the amendment has been said to be the protection of the good functioning of essential infrastructure and the continued provision of infrastructure services, e.g. in the area of telecommunications or energy, the AWG's regime of investment control is not limited to these sectors under the text of the law.

The amendment does not impose a mandatory notification regime upon non-EU investors, nor does it impose a prior authorization scheme. The responsibility to acquire the necessary information on mergers and acquisitions and to intervene in those cases where, according to its own assessment, a danger for the public order or security might exist, is with the Ministry of the Economy. A control procedure can only be initiated within 3 months after the conclusion of the relevant purchase contract. The Ministry of the Economy then has another 2 months to decide whether a threat to the public order or public security exists. If so, it can – with the approval of the government – impose conditions to remedy the threat[94] or prohibit the transaction. A prohibition of the acquisition of the firm, or of the shares of the corporation, shall have the effect of rendering the relevant contract null and void (auflösende Bedingung, § 31(3) AWG).

These types of national foreign investment control regimes raise the question whether they are an adequate response to the perceived threats posed by SWFs or other foreign state-controlled investments – and whether they are compatible with EU law, in particular where they are addressed against non-EU investors. The EU Commission has expressed concerns both with a view to the reformed French investment control regime[95] and with a view to the German reform of the AWG.[96]

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on this see also Müller-Ibold, Foreign Investment in Germany: Restrictions Based on Public Security Concerns and Their Compatibility with EU Law, EYIEL 1 (2010), p. 103.

[92]§ 4 No. 5 AWG uses the term "Gebietsansässige". In particular, this comprises corporations with their seat or headquarters in Germany, or branches of foreign firm managed from the German territory and with a separate accounting system.

[93]§ 7(2) No. 6 AWG: Die Gefährdung der öffentlichen Ordnung oder Sicherheit der Bundesrepublik Deutschland durch den Erwerb gebietsansässiger Unternehmen oder von Anteilen an solchen Unternehmen "setzt voraus, dass eine tatsächliche und hinreichend schwere Gefährdung vorliegt, die ein Grundinteresse der Gesellschaft berührt".

[94]Conditions can, inter alia, take the form a prohibition or limitation of the exercise of voting rights in the target company or the appointment of a trustee to reverse the transaction.

[95]In October 2006, the EU Commission formally requested France to amend its regulations – see IP/06/438 of 4 April 2006 and IP/06/1353 of 12 October 2006. France presented some proposals to address the EU Commission's concerns in February 2008.

[96]The EU Commission has announced that it will review the AWG's compatibility with EU law.

In the context of the discussions surrounding SWF investments, an important question is whether and to what extent member states may be justified in imposing more stringent regimes of entry control on investments originating in non-EU countries as compared with EU investors, and in particular on investments controlled by non-EU states. There is, however, a preliminary question whether Art. 56 TEC (equivalent to Art. 63 TFEU) applies at all to such national foreign investment control regimes which are addressed solely to those cross-border investments by which a third-country national acquires full ownership or control of an EU-based firm or such a substantial stake that, in an intra-EU context, Art. 43 TEC (equivalent to Art. 49 TFEU) would apply.

Does Art. 56 TEC (Equivalent to Art. 63 TFEU) Apply at All to National Foreign Investment Control Regimes Limited to the Acquisition of Control? The Relationship Between Art. 56 and Art. 43 TEC (Equivalent to Art. 63 and Art. 49 TFEU) with a View to Third-Country Investments

Art. 56(1) TEC (equivalent to Art. 63(1) TFEU) prohibits "all restrictions on the movement of capital between Member States and between Member States and third countries". It is the only fundamental freedom which extends to non-EU nationals. The decision to broaden Art. 56's scope of protection was taken with the Maastricht Treaty and accompanied the introduction of the second stage of the economic and monetary union. It was to signal EU's firm commitment to an open investment environment to the world and was based on the conviction that a free inflow of capital would benefit the EU even if it was granted unilaterally. With a view to the broad interpretation which Art. 56 TEC (equivalent to Art. 63 TFEU) has traditionally received, its extension to third-country investors has, however, created substantial conceptual difficulties.[97] Prior to the entry into force of the Maastricht Treaty and thus to the extension of Art. 56 TEC (equivalent to Art. 63 TFEU) to third-country nationals, the ECJ started to refer, in a consistent line of jurisprudence, to a nomenclature of capital movements annexed to Council Directive 88/361[98] to define the scope of protection of the free movement of capital. According to this non-exhaustive list, capital movements do not only include portfolio investments and investments in other instruments normally traded on the capital markets or money markets, operations in current and deposit accounts with financial institutions, loans, credits related to commercial transactions, and real estate, but they also

[97]For a broader discussion see Usher, The Evolution of the Free Movement of Capital, Fordham Int'l L.J. 31 (2008), 1533 et seq.; Lyal, Free movement of capital and non-member countries – consequences for direct taxation, Speech given at the CFE conference on 24 November 2006, available at http://european-tax-adviser.com/worldpress/wp-content/uploads/2007/08/ac2006_lyal.pdf; Peers, Free Movement of Capital: Learning Lessons or Slipping on Spilt Milk?, in: Scott (ed.), *The Law of the Single European Market*, 2002, pp. 333 et seq.

[98]Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, OJ 1988 L 178/5.

comprise so-called direct investments which include the "establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings; participation in new or existing undertakings with a view to establishing or maintaining lasting economic links".[99] From this reading of Art. 56 TEC (equivalent to Art. 63 TFEU), a broad overlap with the scope of protection of Art. 43 TEC (equivalent to Art. 49 TFEU) has resulted.[100] It thus seemed that, if this jurisprudence were upheld after the entry into force of the Maastricht Treaty, the extension of Art. 56 TEC (equivalent to Art. 63 TFEU) to third-country nationals would also extend a substantial portion of the privilege of the free movement of establishment to them – a fundamental freedom which, according to its wording, is reserved to EU nationals.

Despite concerns raised in this regard, the ECJ has not followed suggestions to construe the "new" free movement of capital more narrowly than it had originally been construed, and to distinguish its scope of protection more clearly from that of Art. 43 TEC (equivalent to Art. 49 TFEU) by reducing it to "passive" investments, while reserving the protection of "active" investments for Art. 43 TEC (equivalent to Art. 49 TFEU).[101] Instead, the ECJ has continued to refer to the broad nomenclature of capital movements annexed to Council Directive 88/361.[102] Moreover, the ECJ has rejected propositions to interpret Art. 56 TEC (equivalent to Art. 63 TFEU) differently depending on whether it is applied in an intra-Community

[99] See also ECJ Case C-463/00, *Commission v. Spain*, [2003] ECR I-4581, para. 53: "Points I and III in the nomenclature set out in Annex I to Directive 88/361, and the explanatory notes appearing in that annex, indicate that direct investment in the form of participation in an undertaking by means of a shareholding or the acquisition of securities on the capital market constitute capital movements for the purposes of Article 56 EC. The explanatory notes state that direct investment is characterised, in particular, by the possibility of participating effectively in the management of a company or in its control."

[100] Art. 43 TEC allows all Community nationals "to participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin and to profit therefrom, so contributing to economic and social interpenetration within the Community [...]" (ECJ Case C-55/94, *Gebhard*, [1995] ECR I-4165, para. 25). Among the forms of establishment protected by Art. 43 TEC are the ownership and control of firms in another member state. Although the mere acquisition of a portfolio investment with no influence on the management of the firm is outside the realm of Art. 43 TEC, so-called direct investments, i.e. investments which "serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which the capital is made available in order to carry out an economic activity" are thus protected not only by Art. 56 TEC, but also by Art. 43 TEC.

[101] For a discussion of different proposals see Usher, The Evolution of the Free Movement of Capital, Fordham Int'l L.J. 31 (2008), 1533, at 1544 et seq.; Lyal, Free movement of capital and non-member countries – consequences for direct taxation, speech given at the CFE conference on 24 November 2006, available at http://european-tax-adviser.com/worldpress/wp-content/uploads/2007/08/ac2006_lyal.pdf.

[102] See ECJ Case C-222/97, *Trummer and Mayer*, [1999] ECR I-1661, para. 21: "[...] the nomenclature in respect of movements of capital annexed to Directive 88/361 still has the same indicative value for the purposes of defining the notion of capital movements ...". See also ECJ Case C-463/00, *Commission v. Spain*, [2003] ECR I-4581, paras. 52 et. seq.

context or with a view to movements of capital with third countries. In *A*, the ECJ held:

> Even if the liberalisation of the movement of capital with third countries may pursue objectives other than that of establishing the internal market, such as, in particular, that of ensuring the credibility of the single Community currency on world financial markets and maintaining financial centres with a world-wide dimension within the Member States, it is clear that, when the principle of free movement of capital was extended pursuant to Art. 56(1) to movement of capital between third countries and the Member States, the latter chose to enshrine that principle in that article and in the same terms for movement of capital taking place within the Community and those relating to relations with third countries.[103]

It thereby also rejected far-reaching propositions that third-country nationals relying on Art. 56 TEC (equivalent to Art. 63 TFEU) should be denied the benefit of a direct effect which was allegedly justified only by the specific and novel character of the legal order established by the EC Treaty.[104]

Although the ECJ has rejected a principled differentiation between the scopes of protection of Art. 56, Art. 49 and Art. 43 TEC (equivalent to Art. 63, 56 and 49 TFEU),[105] it has at times – and in particular in its tax-related cases – opted for what has been called a “centre-of-gravity” approach: in the light of an overlap between the scope of protection of Art. 56 TEC (equivalent to Art. 63 TFEU) and the free movement or establishment or the freedom to provide services it may apply only that provision which it finds to be most directly affected if the other is thought to be “entirely secondary”. *Fidium Finanz* has become the leading case in this regard.[106] The ECJ had to decide whether the granting of credit on a commercial basis constituted a provision of service and was thus protected by Art. 49 TEC (equivalent to Art. 56 TFEU), whether instead it fell within the scope of Art. 56 TEC (equivalent to Art. 63 TFEU) or whether both provisions applied in parallel. Despite the fact that Art. 50 TEC (equivalent to Art. 57 TFEU) appeared to designate Art. 49 TEC (equivalent to Art. 56 TFEU) as the “residual” provision, which would have argued in favour of the application of Art. 56 TEC (equivalent to Art. 63 TFEU), the ECJ found that no order of priority should be assumed between the two fundamental freedoms at issue. Rather, they were designed to regulate different situations, each

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[103]ECJ Case C-101/05, “*A-case*”, [2007] ECR I-11531, para. 31, see also ECJ Case 194/06, *Orange European Smallcap Fund NV*, [2008] ECR I-3747, para. 87.

[104]See *AG Geelhoed*, Opinion of 10 April 2003, in: ECJ Case C-452/01, *Ospelt*, [2003] ECR I-9743, paras. 45–47.

[105]For an overview of the relevant case law see Usher, The Evolution of the Free Movement of Capital, Fordham Int’l L.J. 31 (2008), pp. 1533 et seq.(1545 et seq.).

[106]ECJ Case C-452/04, *Fidium Finanz*, [2006] ECR I-9521. Sometimes, ECJ Case C-251/98, *Baars*, [2000] ECR I-2787, para. 22 is also mentioned as a case in point. In *Baars*, the ECJ found that Art. 43 TEC (equivalent to Art. 49 TFEU) applies to fact patterns where a shareholder holds enough of a foreign company’s shares to give him “definite influence” and to “determine its activities”. Since it found Art. 43 TEC to be infringed, it did not answer to the second question posed by the national court which concerned Art. 56 TEC. However, it did not find that Art. 56 TEC would be, in principle, inapplicable.

having their own field of application. Where a national measure relates to the freedom to provide services and the free movement of capital at the same time,

> [. . .], it is necessary to consider to what extent the exercise of those fundamental liberties is affected and whether, in the circumstances of the main proceedings, one of those prevails over the other. The Court will in principle examine the measure in dispute in relation to only one of those two freedoms if it appears in the circumstances of the case that one of them is entirely secondary in relation to the other and may be considered together with it (para. 34).

In the case at hand, the ECJ found that the restriction on free movement of capital was "merely an unavoidable consequence of the restriction on the freedom to provide services" (para. 48). The national rules were therefore to be assessed under Art. 49 TEC (Art. 56 TFEU) alone – a provision on which a company established in a non-member country could not rely (para. 50). On the basis of a similar line of argument, the ECJ held in *Lasertec*[107] that "national provisions relating to holdings giving the holder a definite influence on the decisions of the company concerned and allowing him to determine [the company's] activities come within the material scope of the Treaty provisions on freedom of establishment" (para. 20). Any restrictive effects on the free movement of capital would need to be seen as "an unavoidable consequence of the restriction on freedom of establishment" and would not justify an examination of that measure in the light of Art. 56–58 TEC (equivalent to Art. 63–65 TFEU) (para. 25).[108] Also in *Lasertec*, it followed that third-country nationals could not challenge the relevant national rules, as they did not come within the scope of protection of the freedom of establishment.

It seems that the ECJ's recent case law has firmly established the centre-of-gravity approach in its jurisprudence on the interaction between the free movement of capital, the freedom of establishment and the freedom to provide services. However, the scope of application of this new doctrine remains unclear. Apart from *Fidium Finanz* – a case about banking regulation – the centre-of-gravity approach has mainly been used in tax cases so far. Both banking regulation and tax cases are special in many regards, and are linked in particular ways to issues of territorial sovereignty. In other, non-tax cases, including more recent ones, the ECJ has continuously held that, in principle, Art. 56 TEC (Art. 63 TFEU) and Art. 43 TEC (Art. 49 TFEU) apply in parallel where their scopes of protection overlap.[109]

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[107]ECJ Case C-492/04, *Lasertec*, [2007] ECR I-3775.

[108]See also ECJ Case C-524/04, *Test Claimants in the Thin Cap Group Litigation*, [2007] ECR I-2107, paras. 26–35: in a case where the national legislation at issue was only targeted at relations within a group of companies and primarily affected freedom of establishment; the case should be analyzed under the perspective of Art. 43 TEC alone (paras. 33–35). And ECJ Case C-196/04, *Cadbury Schweppes*, [2006] ECR I-7995, paras. 31–33.

[109]See, for example, ECJ Case C-279/00, *Commission v. Italy*, [2002] ECR I-1425 paras. 36 et seq., an Italian requirement that undertakings engaged in the provision of temporary labour established in other member states have to lodge a guarantee with a credit institution having its registered office in Italy breaches both Art. 49 and of Art. 56 TEC. The ECJ did not give priority to either freedom in this case. In a number of other cases, the ECJ has, after finding an infringement of one of the free-movement rules, found that it is not necessary to analyse the

If the centre-of-gravity approach were indistinctively extended to EU-bound investments by SWFs, those national rules applying to all types of investments – passive or active, portfolio or controlling shares – would likely be analysed under Art. 56 TEC (equivalent to Art. 63 TFEU). In such cases, Art. 56 TEC would presumably be applied even if the specific case at hand were about an attempt to acquire control. At the same time, member states would be free to restrict the acquisitions of *controlling stakes* by third-country investors at will, since Art. 43 TEC (equivalent to Art. 49 TFEU) alone would be applied to those national measures that relate to holdings giving the holder a definite influence on the decisions of a target company.[110]

However, a centre of gravity approach, so broadly understood, would lack any consistent theoretical basis; if the scope of Art. 56 TEC (Art. 63 TFEU) covers controlling stakes in principle, it is difficult to see a justification for denying third-country nationals protection just because in an intra-EU-context the freedom of establishment would primarily apply.[111] From a purely practical perspective, it is doubtful whether the centre-of-gravity approach would meet its apparent goal to protect the member states' full political discretion to regulate third-country acquisitions of control, as third-country investors can gain the full protection of Art. 43 TEC (Art. 49 TFEU) by establishing a subsidiary in any one of the member states.[112]

Much argues in favour of a narrow construction of the ECJ's centre-of-gravity approach, therefore, and to limit it to those cases where the territorial regulatory authority with regard to companies with their seat in a certain member state is of the essence as is true in particular in the area of tax.

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compatibility of a national measure with other free-movement rules – see, for example, ECJ Case C-105/07, *NV Lammer & Van Cleeff v. Belgium*, [2008] ECR I-173, para. 35: "Since the Treaty provisions on freedom of establishment thus preclude national legislation such as that at issue in the main proceedings, it is not necessary to examine whether the Treaty provisions on the free movement of capital also preclude that legislation"; ECJ Case C-314/08, *Filipiak*, [2009] ECR I-000 para. 59.

[110]See ECJ Case C-492/04, *Lasertec*, [2007] ECR I-3775 para. 20 et. seq.

[111]For a critical view see also Martini, Zu Gast bei Freunden? Staatsfonds als Herausforderung and das europäische und internationale Recht, DÖV 2008, pp. 314 et seq.; Weller, Ausländische Staatsfonds zwischen Fusionskonstrolle, Außenwirtschaftsrecht und Grundfreiheiten, ZIP 2008, pp. 857 et seq.; Bayer/Ohler, Staatsfonds ante portas, ZG 2008, pp. 12 et seq.; Schäfer/Voland, Staatsfonds: Die Kontrolle ausländischer Investitionen auf dem Prüfstand des Verfassungs-, Europa- und Welthandelsrechts, EWS 2008, pp. 166 et seq.

[112]Krolop, Stellungnahme zu dem Gesetzesentwurf der Bundesregierung für ein Dreizehntes Gesetz zur Änderung des Außenwirtschaftsgesetzes und der Außenwirtschaftsordnung, Berlin, 22 January 2009, p. 24.

The ECJ's Jurisprudence on the Free Movement of Capital and the Justification of Restraints: A Special Regime for Cross-Border Investments Originating in Non-EU States?

If it is doubtful whether an adequate balance between the protection of a generally beneficial freedom to invest vis-à-vis third countries and the right of the member states to implement safeguards against associated risks can be achieved by curtailing the scope of protection of Art. 56 TEC (Art. 63 TFEU) and differentiating it from the scope of protection of other free-movement rules case by case, an alternative mechanism for balancing individual rights and regulatory limitations may be found at the justification level.[113] Although it would involve a greater measure of control of the actions of member states through EU law, the resulting "de-politicization" of the member states' responses to perceived threats would help to avoid protectionist overreactions. It would thus strengthen the EU's commitment to openness and legal certainty for third-country investors. The necessity to distinguish between intra-EU investments and third-country investments at the justification level has been repeatedly acknowledged by the ECJ.

Justification of Restrictions at the Member State Level: The Legal Framework

According to Art. 57(1) TEC (Art. 64 TFEU), Art. 56 TEC (Art. 63 TFEU) is

> without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment — including in real estate — establishment, the provision of financial services or the admission of securities to capital markets.

This so-called grandfather clause implies that foreign investment controls that were imposed on direct investments originating in third countries before 1994 are per se justified.

National rules implemented later in reaction to the perceived threats of government-controlled investments, including SWFs, like the French reform of 2004–2005 and the German reform of 2009, do not benefit from this privilege, and have to be justified on other grounds.

According to Art. 58 TEC (Art. 65 TFEU), Art. 56 (Art. 63 TFEU) shall be without prejudice to the right of member states to apply their relevant tax laws which distinguish, inter alia, on the basis of the place of residence (Art. 58(a) TEC equivalent to Art. 65(a) TFEU) or to "[...] take measures which are justified on grounds of public policy or public security" (Art. 58(b) TEC equivalent to

[113] See also Lyal, Free movement of capital and non-member countries – consequences for direct taxation. Speech given at the CFE conference on 24 November 2006, p. 5 of manuscript, available at http://european-tax-adviser.com/worldpress/wp-content/uploads/2007/08/ac2006_lyal.pdf.

Art. 65(b) TFEU).[114] Such measures "shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63" (Art. 65(3) TFEU). The ECJ has interpreted Art. 58 TEC (Art. 65 TFEU) in the light of its jurisprudence on restrictions to the free-movement rules generally: national restrictions can be justified where they pursue a legitimate aim and are in compliance with the principle of proportionality.

In the intra-EU context, the ECJ has explored the limits of Art. 58 TEC (Art. 65 TFEU) in its jurisprudence on "golden shares",[115] which it has consistently treated like regulatory interventions, despite their formal design as property rights. According to the ECJ, "golden shares" are justified only if their introduction is based on clearly defined policy objectives that are legitimate and proportionate under the free-movement rules. Only a "genuine and sufficiently serious threat" to the requirements of public policy or of public security affecting "one of the fundamental interests of society"[116] will justify a restriction of the free movement of capital. Interests which the ECJ has recognized as sufficiently fundamental to potentially justify a restriction of the free movement of capital include the security of supply with essential services, such as energy, telecommunications and water,[117] and the essential security of infrastructure networks, including transportation routes and traffic infrastructure.[118] By contrast, pure economic grounds can never serve as

[114]Art. 58(b) EC reads in full: Art. 56 shall be without prejudice to the right of Member States "to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security".

[115]See, inter alia, ECJ Case C-367/98, *Commission v. Portugal*, [2002] ECR I-4731; ECJ Case C-98/01, *Commission v. United Kingdom*, [2003] ECR I-4641; ECJ Case C-483/99, *Commission v. France*, [2002] ECR I-4781; ECJ Case C-463/00, *Commission v. Spain*, [2003] ECR I-4581; ECJ Case C-503/99, *Commission v. Belgium*, [2002] ECR I-4809; ECJ Case C-174/04, *Commission v. Italy*, [2005] ECR I-4933; ECJ Cases C-282/04 and 283/04, *Commission v. Netherlands*, [2006] ECR I-9141. See also ECJ Case C-112/05, *Commission v. Germany (VW)*, [2007] ECR I-8995. For a summary of the case law see also EU Commission, Staff Working Paper: Special rights in privatised companies in the enlarged Union – a decade full of developments, Brussels, 22 July 2005. For comments in the academic literature see Fleischer, Case Note on the Golden Shares Cases, CMLRev. 20 (2003), p. 493; Grundmann/Möslein, Die Goldene Aktie – Staatskontrollrechte in Europarecht und wirtschaftspolitischer Bewertung, ZGR 2003, p. 317; Szyszczak, Golden Shares and Market Governance, Legal Issues of Economic Integration 29 (2002), pp. 255 et. seq.

[116]See ECJ Case C-30/77, *Regina v. Bouchereau*, [1977] ECR p. 1999, paras. 33-35 (public policy); and ECJ Case C-463/00, *Commission v. Spain*, [2003] ECR I-4581 paras. 72 et. seq. (public security).

[117]See ECJ Case C-503/99, *Commission v. Belgium*, [2002] ECR I-4809 (veto right of the ministry against certain measures of a firm that would endanger the security of supply in energy); ECJ Cases C-282/04 and 283/04, *Commission v Netherlands*, [2006] ECR I-9141 et. seq.

[118]ECJ Case C-98/01, *Commission v. UK*, [2003] ECR I-4641.

justification for obstacles to the free movement of capital.[119] The threat to public policy or public security which a restrictive measure is meant to address must be clearly articulated, and the criteria for intervention must be specified in objective terms such that the preconditions for imposing the restriction are transparent and predictable and investors have a sufficient degree of legal certainty. The public authority which imposes the relevant restriction must not be endowed with an overly broad discretion,[120] and it must be subject to judicial control. Finally, the intervention must be proportionate to the identified threat to public policy or public security. Although the ECJ held in *Eglise de Scientologie vs. France* that a prior authorization regime may be justified with regard to foreign direct investments,[121] a prohibition of a given transaction will only be justified if a specific risk is clearly discernible. A prohibition based on a purely speculative risk would likely be considered disproportionate.

The Application of the Legal Framework to Cross-Border Investments Within the EU

According to these rules, restrictions on foreign investments will likely be justified where they are restricted to certain security-relevant industries, in particular the defence and military equipment industries, industries using nuclear materials or industries involved in the production of cryptographic systems. The German rules on the control of acquisition of stakes in firms active in the defence industry or in "cryptographic systems"[122] would thus be in line with EU law. Likewise, a substantial part of the industries listed in the French Decree No. 2005-1739 of 30 December 2005 would indeed seem to be security-relevant – although the initial inclusion of gambling and casinos has likely overstretched the European concept of public security. In clearly security-relevant industries, control regimes may well extend to the acquisition of non-controlling stakes: privileged access to information may suffice to raise relevant security concerns. The thresholds set out in the German AWG (25%) and in French law (one third of the voting rights or control) hence do not raise concerns under EU law. Purely passive portfolio investments, on the other hand, would not seem to raise any significant risks,[123] and neither the French nor the

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[119] See for example, ECJ Case C-54/99, *Eglise de Scientologie*, [2000] ECR I-1335, para. 17 with further references.

[120] ECJ Case C-463/00, *Commission v. Spain*, [2003] ECR I-4581.

[121] ECJ Case C-54/99, *Eglise de Scientologie*, [2000] ECR I-1335, para. 20.

[122] For example, the provision of the German AWG according to which the acquisition of stakes in firms active in the defence industry or "crypto technology" of 25% of the votes or more must be notified to the German government and according to which the government can prohibit such acquisitions on the basis of public security criteria should be considered as justified under Art. 58(1)(b) EC.

[123] Kimmitt, Public Footprints in Private Markets. Sovereign Wealth Funds and the World Economy, Foreign Aff. 87 (2008), p. 119 (123).

German regime of foreign investment control extends its control that far. Moreover, relatively stringent measures of control will likely be justified in security-relevant industries, including notification and prior authorization requirements. The review process should, however, be clearly structured and predictable, with clear time frames that take into account the time sensitivities of major capital market transactions. In particular, it should protect the legitimate confidentiality interests of the parties.[124] In the case of a negative decision, the investor must be entitled to judicial review.

The legality of national investment control regimes becomes doubtful the more they extend beyond the scope of clearly security relevant industries. As the ECJ’s golden share jurisprudence shows, EU law will, in principle, recognize serious dangers for public policy and public security even outside the defence and military equipment industries. Beyond the pure protection of the borders of the state from military attack and the protection against terrorism and espionage, national security includes protecting the public from large-scale threats to its safety and vital interests more broadly understood. The protection of energy security and the protection of other critical infrastructures are examples in point. However, the ECJ has required a clear, objective and predictable specification of the relevant risks in this regard which protects against any hidden forms of discrimination. The recent reform of the Foreign Trade and Payments Act (AWG) in Germany which has extended the foreign investment control regime to potentially all sectors raises serious doubts in this regard: the Ministry of the Economy shall be entitled to intervene whenever it perceives a serious threat to public policy or public security. The kinds of threats that could lead to a prohibition of the investment or conditions being imposed, i.e. the relevant assessment criteria, are not specified. Such a broad reach of the investment control regime, and the discretion it conveys on the Ministry of the Economy, would seem to run counter to the requirement of predictability and legal certainty.

Restrictions on Foreign Investments by Third-Country Investors, in Particular SWFs and SOEs

One may, however, question whether the ECJ’s jurisprudence on the handling of Art. 58 TEC (Art. 65 TFEU) in an intra-Community context can be fully transferred to situations in which a justification of restrictions to the free movement of capital vis-à-vis third countries is at stake. Although Art. 56 TEC (Art. 63 TFEU) defines the scope of protection in a uniform manner for both groups of investors, the threats they create for public policy and public security may objectively differ owing to the different institutional and legal context to which they are subject in their home state. The ECJ has explicitly recognized the relevance of these differences for the breadth

[124]DB Research, Kern, SWFs and foreign investment policies – an update, 22 October 2008, pp. 30.

of potential justifications of restrictions in *A*.[125] In *Orange European Smallcap Fund NV*, it confirmed that it may be that "a Member State will be able to demonstrate that a restriction on the movement of capital to or from third countries is justified for a particular reason in circumstances where that reason would not constitute a valid justification for a restriction on capital movements between Member States".[126] With a view to foreign state-controlled investments, the fact that the state–market relationship is not subject to comparable constraints in third countries as it is in the EU member states and that reflexes of "imperialist capitalism" have not been tamed to the same extent by the rule of law may justify more stringent regimes of control vis-à-vis third-country investors as compared with investors from other member states.

Entry Controls to Address the Risk of Dependency

As far as national entry control regimes are concerned, the approach adopted by the EU itself in its directives on the internal market in electricity[127] and in natural gas[128] (see above) provides important indications regarding the types of restrictions that can be justified. Three aspects of the EU legislation are of particular relevance:

– The EU directives impose restrictions on the acquisitions of control of energy networks by third-country investors – restrictions which will not apply to EU investors – in particular with a view to addressing risks of dependence vis-à-vis third countries. Within the EU, the risk of dependence is constrained by EU law and by the intense interdependence which both the institutional structure and the common market create. With regard to third countries, the risk may be more acute, however – albeit to different degrees, depending on the type of investment, the third country involved and the degree of economic, legal and political interaction that exists. Generally, a risk of dependence will be created only by an acquisition of control; the acquisition of a minority stake would not appear to involve similar risks. The risk may be particularly acute in the case of *state-controlled* investments – the ownership structure may clearly be a relevant

[125] ECJ Case C-101/05, "*A-Case*", [2007] ECR I-11531, para. 60: the ECJ emphasizes that movements of capital to or from third countries take place in a "different legal context" compared with intra-Community movements and that, therefore, "case-law, which relates to restrictions on the exercise of freedom of movement within the Community, cannot be transposed in its entirety to movements of capital between Member States and third countries." The ECJ refers, in particular, to Community legislation which "established a framework for cooperation between the competent [tax] authorities of the Member States which does not exist between those authorities and the competent authorities of a third country where the latter has given no undertaking of mutual assistance" (para. 61). For a similar reasoning see ECJ Case C-194/06, *Orange European Smallcap Fund NV*, [2008] ECR I-3747, paras. 89–90.

[126] ECJ Case C-194/06, *Orange European Smallcap Fund NV*, [2008] ECR I-3747, para. 90 with further references.

[127] Art. 11 of Directive 2009/72/EC of 13 July 2009, OJ 2009 L 211/55.

[128] Art. 11 of Directive 2009/73/EC of 13 July 2009, OJ 2009 L 211/94.

assessment criterion. But with a view to possible informal state influence, the line between openly state controlled investments and apparently private investments can be blurred. National control regimes may therefore extend to private investments as well.

– The EU energy directives reverse the burden of proof: whereas it is normally for the member state that restricts free movement to prove the necessity and proportionality of the restrictions, the EU energy directives provide that it is for the applicant to demonstrate the absence of a risk to security of supply. As the types of threats that may justify restrictions remain relatively vague, this burden is a heavy one.
– Contrary to general principles of EU law, the EU energy directives allow for a "piercing of the corporate veil": in determining whether the rules for intra-EU investment or the rules for third-country investment apply, it is ultimately not the nationality of the investing entity that matters. Rather, the directives look to the nationality of the controlling entity to identify the existence and seriousness of a threat.

It is likely that the member states may rely on similar principles in designing entry control regimes for third-country investors as far as the acquisition of control of important infrastructures or natural resources is concerned or wherever a plausible threat of dependence can be identified. Arguably, the EU law requirements as regards the exact specification of the risk to public order or public security are somewhat lower vis-à-vis those for third-country investors. This will also weaken the proportionality analysis. Nonetheless, there will be little room for restrictive investment entry policies outside the realm of the most important infrastructure industries.[129] Foreign investments in most reasonably competitive industries will not have the potential to create dependence. Risks of harm to the interests of a target company and its shareholders, to the stability of financial markets, or risks of industrial espionage are difficult to address at the stage of a public entry control procedure, on the other hand, that is at a stage where they necessarily remain theoretical and speculative. Rather, such risks must be addressed as they arise. The increased relevance of third-country state-controlled investments thus requires a review of whether the general rules of corporate law, capital market law and competition law must be adjusted to address the specific risks such investments may raise.

Modifications of General Rules of Corporate Law, Securities Regulation and Competition Law?

General Rules of Corporate Law and Corporate Governance An issue remains whether foreign investments by state-controlled third-country investors may justify (and from a national perspective possibly require) a modification of the general rules of corporate law, securities regulation and competition law. Do such

[129] OECD, Building Trust and Confidence in International Investment, March 2009, p. 10.

investments raise risks that cannot be adequately addressed within the framework of the general rules?

Conflicts of interest may be considered the most obvious risk resulting from third-country controlled investments in national firms. They may arise where a third-country investor acquires a majority stake in the pursuit of interests which clearly diverge from the goal of shareholder value maximization, or where an important minority position is used to gain access to, and misappropriate, important information, to block important strategic decisions etc.[130]

Conflicts of interests between majority and minority shareholders are not specific to foreign state-controlled investments, however. They are addressed by the general rules regulating the conduct of majority shareholders, and in some countries by the law on corporate groups. The misappropriation of information by a shareholder is likewise dealt with under the general rules of corporate law.

What remains is a potential "systemic risk": where state-controlled third-country investors would acquire control of European firms on a broad scale and systemically replace the normal profit-maximization goal of firms with a regime of political goals, market processes could be seriously distorted.[131] It seems to be this concern that *Gilson* and *Milhaupt* intend to address with their far-reaching proposition to deprive SWFs or other foreign state-controlled investors of the voting rights attached to their shareholdings.[132] The idea is to separate investment value from control. Sovereign equity investors shall be able to generate returns identical to those of other shareholders; but they shall have no direct influence over management through voting. Within such a regulatory framework, sovereign investors with purely financial motives would invest, but sovereign investors seeking strategic benefits would likely find an investment unattractive and would withdraw. According to *Gilson* and *Milhaupt*, the integrity of the structure of capitalism could thus be ensured.

Contrary to their claim that this is a "minimalist response to the new mercantilism", it is, however, a drastic one: the threat to which it responds has not materialized, nor do the available data suggest that it is imminent. Relatively rarely do

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[130]For this type of concern see Gilson/Milhaupt, Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Merchantilism, Stanford University Law and Economics Olin Working Paper No. 355, p. 21: "... an SWF may have a strategic motive in addition to, or instead of, an investment motive. The SWF may wish to help domestic companies secure technology or other expertise from a portfolio company even if that transfer reduces the portfolio company's value – the loss to the portfolio company is shared by all owners, while the transfer for the benefit of the SWF's government accrues entirely to it".

[131]For such a concern see, for example, Cox, The Role of Government in Markets. Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government, 24 October 2007, at http://www.sec.gov/news/speech/2007/spch102407cc.htm.

[132]According to Gilson and Milhaupt, the voting rights would be regained when the sovereign investor transfers its stake to a non-state owner. This mechanism shall ensure that the full value of the investment can be realized. See Gilson/Milhaupt, Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Merchantilism, Stanford University Law and Economics Olin Working Paper No. 355, p. 10.

SWFs acquire control of European companies, and even anecdotal evidence of a politicization of the management of European companies by third-country shareholders is absent so far. Instead, there is substantial empirical evidence that stock prices react positively to the announcement of an investment by SWFs.[133] At the same time, *Gilson* and *Milhaupt's* proposal breaks with fundamental principles of corporate governance: in recent years, attention has turned once again to the importance of shareholder activism in monitoring management. Disempowering investors with an important stake in a company and thus a real interest in effective control may be counterproductive in this regard. It will increase the power of management – and the management's interest in securing investments by SWFs.

Financial Market Regulation To date, there is no evidence that the conduct of SWFs or other foreign state-controlled investment poses specific risks to the stability of financial markets.[134] Rather, there is substantial evidence that SWFs, typically acting as long-term investors with mainly unleveraged positions, can have a stabilizing effect. They can sit out longer during market downturns or even trade against market trends.[135] Although they hold large and frequently non-transparent positions such that a sudden sale could potentially lead to market disturbances, it will be in their own best interests for SWFs to pursue portfolio reallocations gradually so as to limit adverse price effects.[136] As regards the potential systemic effects of SWF disinvestments, it has been observed that a withdrawal of foreign government investments from the equity market may be less of a strategic threat than if the investments had remained entirely in US government debt.[137]

Nonetheless, there is an intense debate whether new financial market regulation regarding, *inter alia*, investments by SWFs is needed. The debate mainly centres on transparency rules.[138] The former SEC chairman Christopher Cox has argued that the opacity of the SWFs' investments creates a risk of market abuse and insider

[133]Sun/Hesse, Sovereign Wealth Funds and Financial Stability – An Event Study Analysis, IMF Working Paper, October 2009, WP/09/239.

[134]See, in particular, Beck/Fidora, The Impact of Sovereign Wealth Funds on Global Financial Markets, ECB Occasional Paper Series No. 91 (2008), pp. 23, 24.

[135]Sun/Hesse, Sovereign Wealth Funds and Financial Stability – An Event Study Analysis, October 2009, IMF Working Paper WP/09/239, p. 3.

[136]Sun/Hesse, Sovereign Wealth Funds and Financial Stability – An Event Study Analysis, October 2009, IMF Working Paper WP/09/239, p. 3.

[137]Gilson/Milhaupt, Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Merchantilism, Stanford University Law and Economics Olin Working Paper No. 355, kp. 8

[138]For a call for greater transparency see, for example, EU Commission Communication: "A common European approach to Sovereign Wealth Funds, COM(2008)115, p. 10; former SEC Chairman Christopher Cox, The Role of Government in Markets. Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government, 24 October 2007, at http://www.sec.gov/news/speech/2007/spch102407cc.htm.

trading.[139] Others have claimed that increased transparency is needed to allow markets to anticipate the broad allocation and risk-preference trends of this investor class, thus avoiding inaccurate pricing and market volatility.[140] Finally, policy makers in host countries may need more data, and thus more disclosure, to assess the potential existence and size of systemic risks.[141] These issues are at least partly specific to SWFs. They cannot be equated with the general disclosure requirements which all market participants are subject to under the various regimes of financial market regulation. In the future, financial market regulators may thus develop specific disclosure regimes for SWFs.

But calls for regulation sometimes go further. For example, it is currently being debated whether the EU Commission's proposal for a directive on alternative investment fund managers (AIFMs),[142] if it were to enter into force, would apply also to SWFs. The proposed directive strives to establish common regulatory and supervisory standards for hedge funds, private equity funds and other systemically important market players to address a variety of risks associated with such investments, ranging from macroprudential (systemic) risks to, *inter alia*, microprudential risks, risks regarding market efficiency and integrity. It requires managers of all alternative investment funds (AIFs) covered by the directive to receive authorization by a regulatory authority for marketing their fund to professional investors. The authorization will be based on a demonstration that the manager is suitably qualified to provide AIF management services, and on detailed information on the planned activity of the fund. The AIFM will be required to hold and retain a minimum level of capital. He must, moreover, satisfy the competent authority of the robustness of the risk management, the management and disclosure of conflicts of interest, the fair valuation of assets and the security of depository/custodial arrangements. The proposed directive sets out far-reaching disclosure requirements on various levels. A minimum level of service and information must be provided on an ongoing basis to the investors in the fund. In addition, the AIFM is required to report to the competent authority on a regular basis on the principal markets and instruments in which the fund trades, its principal exposures, performance data and concentrations of risk. The acquisition of a controlling interest in a company must be reported to its shareholders and the representatives of employees. The EU

[139]Cox, The Role of Government in Markets. Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government, 24 October 2007, at http://www.sec.gov/news/speech/2007/spch102407cc.htm.

[140]For this argument see Sun/Hesse, Sovereign Wealth Funds and Financial Stability – An Event Study Analysis, October 2009, IMF Working Paper WP/09/239, p. 3; Cox, The Role of Government in Markets. Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government, 24 October 2007, at http://www.sec.gov/news/speech/2007/spch102407cc.htm.

[141]See Weiss, CRS Report for Congress: Sovereign Wealth Funds: Background and Policy Issues for Congress, 2008, p. 14, available at http://fpc.state.gov/documents/organization/110750.pdf.

[142]Proposal for a Directive of the European Parliament and the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/.../EC, COM(2009)207 final of 30 April 2009.

Commission may, through comitology procedures, set leverage limits where this is required to ensure the stability and integrity of the financial system.

The primary targets of the directive are hedge funds and private equity funds. SWFs are not easily subsumed under the definition of "alternative investment funds" (AIFs) in Art. 3(a) of the proposed directive.[143] In fact, an application of the directive to SWFs would be inappropriate, at least in part. Hedge funds and private equity funds differ in their structure and in the concerns they raise. SWFs, however, differ from both. Investor protection is not an issue with regard to SWFs; nor are they known to typically engage in highly leveraged transactions. In light of the remarkable variety of investment policies pursued by SWFs – some acting more like pension funds, some more like strategic investors – it seems that any regulatory regime meant to capture SWFs that would reach beyond transparency requirements would need to start from a definition of specific risk scenarios. To this day, these risk scenarios have not been well defined.

Competition Rules Finally, the risk of a distortion of competition which foreign state-controlled third-country investments might entail does not appear to be sufficiently concrete and severe to justify special restrictions for the investment of SWFs or third-country SOEs. Indeed, non-EU investors may be subject to a much more lenient competition law regime in their home states, and competitive advantages may result in particular for third-country SOEs. In some cases, they may cross-subsidize their EU activities with monopolistic profits gained elsewhere. SWFs and SOEs may have access to state resources which would qualify as state aid, and hence be prohibited, in an EU context.[144] The positive ratings that SWFs have typically received, and thus their access to finance on particularly attractive terms, have so far been based on an implicit presumption that large SWFs would be bailed out by the home states.[145] Foreign government-controlled and government-financed market operators may thus not be subject to the full pressure of the market.[146] It is, however, relatively unlikely that SWFs and SOEs will enjoy privileges of a scale such that competition within European markets would be seriously distorted in the longer term. The incentives for foreign governments to subsidize the activities of their entities abroad – and thus to subsidize foreign consumers – will normally be limited. The great importance of state aid control within the EU is linked to an environment where the subsidizing state is omnipresent, and pursuing a broad scope of politically motivated interests in the economy. This is not equally true for a foreign state. A politically motivated intervention

[143]In Art. 3(a), "alternative investment funds" are defined as "any collective investment undertaking, including investment compartments thereof whose object is the collective investment in assets and which does not require authorisation pursuant to Article 5 of Directive 2009/.../EC [the UCITS Directive]". It is unclear whether SWFs are "collective investment undertakings".

[144]Based on the "private market investor test".

[145]This assumption has come under review, however, in the context of the crisis of Dubai World and Dubai's refusal to take rescue measures.

[146]See OECD, Competition Law and Foreign-Government Controlled Investors, January 2009, pp. x3 et seq.

by a foreign state in the actions of an SOE or an SWF that runs counter to its own commercial interests should not be expected to be of systemic importance. It should rather be a relatively rare and isolated act.

Possible exceptions to this rule may exist in markets where competition is already weakened, and subsidies granted for a limited period may contribute to the creation or strengthening of dominance. Normally, this risk will be greater with vertically integrated SOEs than with SWFs.[147] If in a concrete setting such a risk can be identified, the relevant firm's conduct will be analysed under the EU and/or national competition rules. The EU state aid rules would not apply to subsidies granted by a third-country state; but a conduct based on privileged non-market driven access to finance could potentially be analysed under Art. 82 TEC/Art. 102 TFEU. One shortcoming of the EU regime vis-à-vis Sec. 2 Sherman Act might be that, based on its wording, it does not seem to apply to the creation of dominance, but presupposes the existence of dominance. The ECJ might opt to reinterpret Art. 82 TEC/Art. 102 TFEU more widely, and along the lines of Sec. 2 Sherman Act, however, where otherwise serious risks to the competitive order would result. Similarly, Art. 82 TEC/Art. 102 TFEU could be applied to any attempts by foreign state-controlled dominant firms to inflict harm through boycotts, drastic increases of prices or a systematic discrimination of certain firms.

European Restrictions of the Free Movement of Capital by Third-Country Investors

Art. 57(2) TEC/Art. 64 TFEU empowers the Council, acting by qualified majority and on a proposal by the Commission, to adopt measures on the movement of capital to or from third countries involving direct investment, establishment, the provision of financial services or the admission of securities to capital markets. It reflects a decision that, with the European Monetary Union, the main competence for legislative measures concerning free movement of capital has shifted from the member states to the EU. However, where a measure will restrain rather than liberalize the movement of capital to and from third countries, unanimity shall be required. Although this requirement underlines the EU's strong commitment to a liberal investment and capital movement regime on an international scale, it may be too narrowly construed to answer effectively the challenges that a broad construction of Art. 56 TEC/Art. 63 TFEU poses. The overlaps between Art. 56 TEC (Art. 63 TFEU) and Art. 43 TEC (Art. 49 TFEU) and the relative ease by which third-country investors can gain the protection of the latter by establishing themselves in any one member state, thus circumventing other member states' restrictions, show that

[147] See also Truman, A Blueprint for Sovereign Wealth Fund Best Practices, Peterson Institute Policy Brief No. PB08-3, April 2008 p. 15: "The US-suggested principle that an SWF should commit to compete fairly with the private sector is more relevant to the activities of a government-owned or government-controlled financial or nonfinancial corporation than to an SWF except to the extent that the SWF acts to support another government-owned or government-controlled entity".

national controls of foreign direct investment can easily become ineffective, even where they are justified under EU law. The possibility for member states to establish controls that “pierce the corporate veil” partly answers this threat – but is an awkward instrument under EU law. Thus, much argues for a EU response to the challenges raised by third-country investments generally, and by SWFs and other foreign government-controlled investments in particular. These challenges may involve a need to impose tailored restrictions at the European level – restrictions which the EU should be empowered to implement acting by qualified majority.

Conclusions

In the intra-EU context, the principle of neutrality vis-à-vis private or public ownership is deeply engrained in the structure of EU law (Art. 295 TEC/Art. 345 TFEU). It is matched by intense legal constraints imposed on member states’ interventions in markets, including Art. 86(1) TEC/Art. 106(1) TFEU and the state aid rules. These rules have no equivalent at the international level nor, for the most part, at the national level of non-EU states. The principle of neutrality vis-à-vis private or public ownership can therefore not be transferred to non-EU investors: state control or ownership of investment vehicles can be an important aspect in defining and assessing risks to legitimate national interests resulting from third-country investments.

The main international concern with SWF cross-border investments and investments by other state-controlled entities is that the sponsoring states may use these investment entities as instruments of “imperialistic capitalist” strategies, that is that they will use the influence or control they gain in other target companies not for the end to maximize returns, but to maximize the interest of the sponsoring state, e.g. by obtaining access to technology or expertise that will help the sponsoring state to pursue an aggressive industrial policy at the cost of the interest of other shareholders of the target companies and/or at the interests of the host states.[148]

According to some observers, some SWFs (as well as SOEs) have indeed pursued such strategies in developing countries. Taking advantage of the weak institutional and regulatory framework, they have acquired strategic stakes in those countries’ natural resources, infrastructure and defence sectors.[149] At the same time, SWFs have been careful not to act in such a fashion in Western industrialized countries so far – possibly in anticipation of an expected retaliatory response. Nonetheless, the risk as such cannot be completely dismissed.

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[148]For this concern see, for example, EU Commission Communication “A common European approach to Sovereign Wealth Funds”, COM(2008) 115 provisional, p. 5 at 2.2.

[149]Balin, Sovereign Wealth Funds: A Critical Analysis, 2009, available at SSRN: http://ssrn.com/abstract=1477725.

Within the EU, a proportionate response to the remaining risk – a risk contained by the possibility to react ad hoc to a manifest abuse – should be based on the general European commitment to an open investment environment. The application of Art. 56 TEC (Art. 63 TFEU) is the most important instrument in this regard, as it subjects national responses to perceived risks to public security and public policy to the rule of law and thus helps break the dangerous spiral between "imperialistic capitalism" and protectionism. It does not call into question the member states' ability to defend against real risks, but it requires the member state to clearly and plausibly define the relevant risks, and subjects national measures to judicial review by the ECJ. These beneficial effects will only materialize, however, if Art. 56 TEC (Art. 63 TFEU) is consistently applied. If the ECJ were to apply the centre-of-gravity approach to the member states' regulatory regimes and thus allow them to develop policies regarding controlling investments by third-country investors outside the realm of Art. 56 TEC (Art. 63 TFEU), the rationalizing effect of EU law is lost and the door for protectionist sentiments at national level is re-opened. In the absence of the constraints of EU law, member states have frequently tended towards discretionary frameworks of entry control.

In applying Art. 56 TEC (Art. 63 TFEU) to third-country investments, one must recognize that different risks may be attached to them – and in particular foreign state-controlled third-country investments – as compared with pure intra-EU cross-border investments. Broader restrictions of third-country investments may therefore be justified. Three different categories of risks associated with foreign state-controlled investments can be distinguished: public security risks resulting from investments in security-relevant industries (defence, military equipment, nuclear energy, etc.); risks of dependence resulting from the acquisition of control of strategic infrastructures; and more general risks of an abuse of influence or control by the foreign investor within the target company, of a misappropriation of intellectual property or trade secrets, of a destabilizing effect on capital markets, of distortions of competition, etc.

The first two categories of risk justify a regime of ex ante control – but must be limited to sensitive industries. Restrictions on investments into security-relevant industries, even on investments below the threshold of control, can be broadly justified. Risks of dependence on a foreign investor resulting from the acquisition of control of strategic infrastructures should be verified carefully case by case and will justify restrictions on cross-border investments only in a narrow set of cases where they are necessary to respond to clearly specified risks. The approach developed in Art. 11 of Directive 2009/72/EC concerning common rules for the internal market in electricity[150] and in Art. 11 of Directive 2009/73/EC concerning common rules for the internal market in natural gas[151] with regard to controlling investments in essential infrastructures is of special interest in this regard. This is true in particular with a view to the "piercing of the corporate veil" it allows with a view to

[150]Directive 2009/72/EC of 13 July 2009, OJ 2009 L 211/55.

[151]Directive 2009/73/EC of 13 July 2009, OJ 2009 L 211/94.

distinguishing between intra-EU investments and foreign investments, with a view to the consideration it gives to the political context and international legal commitments to which a third-country investor is subject and with a view to the easing of the burden of proof regarding the existence and imminence of a risk. By contrast, the approach chosen by the German legislator in the course of its most recent reform of the German Foreign Trade and Payments Act (AWG) – a generalized foreign investment entry control in cases which involve a "serious threat to public policy or public security" – does not comply with the EU law requirements of predictability and legal certainty, since it does not specify the type of threat to be addressed and the conditions in which such threat becomes real.

The third category of risks should be addressed through the general laws of each host state (corporate law, capital market law, competition law, etc.). Here, more work will be needed to specify the type of risks that may go along with SWF investments and to insert adequate regulatory responses into the general framework rules.

Developing a real "common European approach" to SWFs beyond the merely complementary soft-law approach that the EU Commission has outlined in its recent communication[152] remains a challenge to be met. A common European framework for national regulatory reactions to all three categories of risk outlined above would effectively contain the danger of protectionist overreactions at national level, and it could provide more effective rules on the entry of third-country investments into the EU (where they will then freely circulate).[153]

The EU law perspective on non-EU SWFs must be distinguished from its perspective on the establishment of SWFs by member states. Recently, France – after having unsuccessfully lobbied for a European SWF to defend European strategic industries against foreign takeovers – has created its own *Fonds Stratégique d'Investissement*. The fund, capitalized with EUR 20 billion, shall help French enterprises in need of stable investors to finance their projects. More specifically, the objectives of the French SWF include the support of promising SMEs which have difficulties in accessing finance, safeguarding the capital of strategic enterprises and providing temporary help to undertakings of strong potential to develop innovative, risky projects. In principle, the SWF shall invest in profitable projects that generate revenue, it shall only acquire a minority of the capital of the target companies, it shall team up with private partners and it shall primarily engage in long-term investments. The creation of such an SWF and its investment activities must again be assessed within the framework of the free-movement rules, and in particular of Art. 56 TEC/63 TFEU – but also within the framework of the state aid rules. With a view to the applicability of Art. 56 TEC/63 TFEU, the main challenge is to establish whether such an SWF can be said to act in a purely private capacity,

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[152]EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional.

[153]EU Commission Communication "A common European approach to Sovereign Wealth Funds", COM(2008) 115 provisional, p. 7–8.

or whether it is an instrument for the state to act in a regulatory capacity. On the basis of the general EU law principle of neutrality vis-à-vis public or private ownership, Art. 56 TEC would apply with full force only in the latter case. In any case, any discrimination based on nationality – for example selective interventions to protect French companies against foreign takeovers – would be outlawed. The goals pursued by the French SWF suggest that it must be assessed primarily against the state aid rules, however, in particular the Community Framework for State Aid for Research, Development and Innovation[154] and the Community Guidelines on State Aid to Promote Risk Capital Investments in Small and Medium Enterprises.[155] The ECJ has tended to treat the state aid rules as lex specialis vis-à-vis the free-movement rules to the extent that the relevant effects of a measure on the internal market are fully captured by the state aid rules.[156] Only where a clear-cut infringement of the free-movement rules could be easily established were the free-movement rules applied in parallel.[157]

[154]OJ 2006 C 323/1.

[155]OJ 2006 C 194/2.

[156]See ECJ Case 47/88, *Iannelli v. Meroni*, [1977] ECR 557, para. 9/10; see also CFI Cases T-197/98 and T-198/98, *Weyl Beef Products v. Commission*, [2001] ECR II-303, paras. 77 et seq.

[157]ECJ Case 21/88, *Du Point de Nemours Italiana*, [1990] ECR I-889 paras. 10 et seq.

The Role of the IMF as a Global Financial Authority

Rosa M. Lastra

Introduction

The financial crisis has taught us many lessons. One of them is that financial institutions are only global in good times, they retrench to national frontiers when things turn sour. However, this state of affairs has to change if financial institutions and markets can credibly claim to be global. This suggests that international solutions are needed for international problems. In this context, I contend that the International Monetary Fund, the institution at the centre of the international monetary and financial system, is best placed to adopt a role as a 'global sheriff' (echoing the words of George Soros in the 2010 Davos meeting) with regard to international financial stability.

This paper focuses on the surveillance function, leaving aside other functions that should also be coordinated at the international level, such as dispute settlement and rule-making (regulation).

The Case for a Global Financial Authority

The challenges that the international monetary and financial system faces in the twenty-first century are very different from the challenges the Bretton Woods institutions – the International Monetary Fund and the World Bank – confronted when they started operations in Washington DC in 1946.[1]

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[1]For an extensive analysis of the law of the IMF, its history and the challenges faced by the institution, see Lastra, *Legal Foundations of International Monetary Stability*, 2006, chapters 12–14. This paper draws on chapter 13 and 14 of the book.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_5, © Springer-Verlag Berlin Heidelberg 2011

The worldwide change from fixed to floating exchange rates, following the collapse of the par value regime, also signified a more profound change in the nature of the IMF. The shift in emphasis from being primarily an international monetary institution focusing on issues such as exchange rate stability and convertibility, to becoming an international financial institution with a broader array of responsibilities, encompassing not only monetary issues, but also other financial issues, such as the regulation and supervision of banking and capital markets, financial reform, debt restructuring and others. The global financial crisis 2007–2009 (with its peak in 2008) gives support to the case for a global financial authority.

The IMF is not only the international monetary institution *par excellence*; the IMF is also at the centre of the international financial system.

At a national level, it has become now widely accepted that regulation and supervision are different functions (albeit interrelated);[2] such distinction is now also made at the European level and it should be made at the international level. A further distinction is now also made between macro and micro supervision. According to the House of Lords Report on the Future or EU Supervision and Regulation,[3] 'macro-prudential supervision is the analysis of trends and imbalances in the financial system and the detection of systemic risks that these trends may pose to financial institutions and the economy. The focus of macro-prudential supervision is the safety of the financial and economic system as a whole, the prevention of systemic risk. Micro-prudential supervision is the day-to-day supervision of individual financial institutions. The focus of micro-prudential supervision is the safety and soundness of individual institutions as well as consumer protection'. A common trend in response to the crisis is to give the central bank responsibility for macro-prudential supervision.

An analogy can be made between the role of the central bank at the national level and the role of the IMF at the international level. A central bank is typically entrusted by national law to maintain monetary stability in the domestic jurisdiction. The IMF is the international institution entrusted by an international treaty (the IMF Articles of Agreement) to promote stability in the international monetary order. The evolution of national central banks in recent years is characterized by the increasing importance and attention give to the goal of financial stability, as part of the mandate of the central bank (with or without supervisory responsibilities). By analogy, the interpretation of the mandate of the IMF (according to the broad enumeration of goals in Article I of the Articles of Agreement, reproduce below) has been expanded over the years and the pursuit of international financial stability has become an important objective in the international financial architecture.[4]

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[2]See Lastra, *Central Banking and Banking Regulation*, 1996, chapter 2, for a distinction between supervision and regulation.

[3]See http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeucom/106/106i.pdf.

[4]Lord Eatwell and Lancey Taylor have proposed the creation of a World Financial Authority in their book *Global Finance at Risk: the Case for International Regulation*, 2008; see also Alexander/Dhumale/Eatwell, *Global Governance of Financial Systems. The International Regulation of*

The Legal Basis

The International Monetary Fund is the institution best placed to assume the role of global financial authority. In my opinion, a creative interpretation of Article I and Article IV of the IMF Articles of Agreement provides the legal basis for the Fund to expand its surveillance role into issues of financial stability.

In terms of the official interpretation of the Articles of Agreement, the Board of Governors at its first meeting in 1946 made a broad delegation of powers to the Executive Board, in accordance with the possibility foreseen in Article XII, Section 2(b). According to the current text of Section 15 of the IMF's By-Laws: 'The Executive Board is authorised by the Board of Governors to exercise all the powers of the Board of Governors, except for those conferred directly by the Articles of Agreement on the Board of Governors'. The Executive Board does indeed have the power of interpretation, though this power has to be exercised consistent with general principles of interpretation, including those set forth in the Vienna Convention on the Law of Treaties.[5]

The objectives of the IMF, which are to guide all its policies and decisions, are defined in Article I of its Articles of Agreement:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of productive resources of all members as primary objectives of economic policy.
(iii) To promote exchange rate stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
(iv) To assist in the establishment of multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
(v) To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members. smoothly functioning payment systems, promotion of international monetary cooperation.

Systemic Risk, 2005, as well as Ohler, International Regulation and Supervision of Financial Markets After the Crisis, EYIEL 1 (2010), pp. 3–29.

[5]See http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf, in particular Articles 31 and 32 (Section 3, "Interpretation of Treaties").

This broad enumeration of goals has allowed the institution to survive over the years, adjusting and readjusting its role in response to diverse economic circumstances. The reference in Article I (i) to international monetary problems can be construed nowadays as a reference to international monetary and financial problems. The same can be said about the reference in Article I (vi) to the promotion of international monetary cooperation, which can be construed as a reference to international monetary and financial cooperation.

The process of international financial standard setting (the growth of soft law) is a key feature of the evolving 'international financial architecture'. The IMF is not the only international financial standard-setter, nor is it currently the most relevant one. This regulatory function is shared by a number of formal international organizations, informal groupings and *fora* of an international character (with the Basel Committee on Banking Supervision and other Committees that have grown under the auspices of the Bank for International Settlements, playing a significant role), professional associations and other entities. However, the IMF is uniquely placed to monitor the compliance with standards through its function of surveillance and through its assessment of the health of the financial sector (via the Financial Sector Assessment Program, FASP, and the Reports on the Observance of Standards and Codes, ROSCs) and to provide countries with the incentive to observe those standards through the design of conditionality. [A sheriff does not make rules, but enforces and makes sure individuals comply with the rules. By analogy, a global sheriff is not expected necessarily to make the rules, but to monitor countries' observance with such rules].

The IMF is the only institution (other than the Bank for International Settlements[6]) that has international legitimacy, an array of functions (surveillance, conditional financial assistance and technical assistance), appropriate financial resources and staffing to assume the role of global financial authority. Other informal international standard setters, such as the Financial Stability Board,[7] the Basel Committee on Banking Supervision or IOSCO, can continue with their rule-making role, but only the Fund can effectively contribute to the enforcement of those standards through its surveillance function. The IMF can play a role similar to that played by the Financial Action Task Force (FATF) with regard to AML/CFT (anti-money laundering/countering the financing of terrorism) standards. In the same way as the FATF seeks partnership with the IMF, World Bank, FATF regional bodies, national financial intelligence units (FIUs) and even the financial industry itself[8] to verify the observance of AMF/CFT standards and to ensure that every country in the world is assessed using the same methodology, the IMF can also seek

[6]See Lastra, *Legal Foundations of International Monetary Stability*, 2006, chapters 12 and 14.

[7]For a brief summary of the functions of the FSB and the functions of the IMF see http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeucom/106/106i.pdf, chapter 8 of the House of Lords' Report.

[8]See Freis, "Global Markets and Global Vulnerabilities: Fighting Transnational Crime Through Financial Intelligence", prepared remarks for the MOCOMILA meeting in Salamanca on 25 April 2008, available at http://www.mocomila.org/meetings/2008-freis.pdf.

to further develop partnerships with other national, regional and international bodies to ensure adequate implementation of adequate standards for supervision, regulation and resolution of financial institutions.

Of course, from a legal perspective, the IMF is not expected to supervise institutions. Indeed the supervisory function it should exercise is 'surveillance of financial sector policies', i.e., super-vision of how country comply with standards, and what type of procedures and tools they have in place for resolution, supervision, regulation and others. Surveillance, is therefore key to the understanding of the role of the IMF in the twenty-first century.

The main functions performed by the IMF in relation to its members are surveillance (Article IV of the IMF Articles of Agreement), financial assistance (Article V, Section 3) and technical assistance (Article V Section 2 (b)). The Fund uses surveillance, financial assistance and technical assistance as instruments to accomplish its objectives or purposes as defined in Article I. From the point of view of the member states, they constitute the main 'services' that the Fund provides to them. From the Fund's perspective, its powers can be broken down into three categories: (i) regulatory (jurisdiction), comprising Article VIII Section 2 and Article IV; (ii) financial (Article V, Section 3), and (iii) advisory (technical assistance, Article V Section 2(b)).

The authority of the IMF to perform specific services for members that are not mentioned in the Articles but are sufficiently related to the purposes of the institution is made explicit by the Second Amendment, Article V Section 2(b). While surveillance applies to all members, conditional financial assistance and technical assistance only apply to the members that request such assistance. The mandatory nature of surveillance contrasts with the voluntary nature of technical assistance.[9]

Surveillance

The legal basis of surveillance is Article IV, Sections 1 and 3, as amended. Article IV Section 1 imposes a set of obligations upon members, further explained below. To make these obligations effective, the Fund is granted powers to oversee, to monitor the compliance of each member with these obligations.

[9]From the Fund's point of view, surveillance is the key function. From the member countries' point of view, financial assistance is the key. Countries in need (of balance of payments support) subject themselves to conditionality, surveillance and technical assistance as the price that must be exacted to obtain financial support. Members are not always keen to tighten their belts or the belts of their citizens to obtain the resources they need to address balance of payments difficulties, but they are well aware that non-observance of their financial obligations with the Fund will lead them into further trouble.

Article IV Section 3 (a) confers upon the IMF a clear role in this regard:

> The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article.

Article IV Section 3(b) further states:

> [T]he Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies.

The principles of surveillance were set out in further detail in a 1977 decision[10] which was replaced by a new Decision of 2007.[11] The Decision of 15 June 2007 crystallizes a common of the best practice of surveillance, and covers exchange rate policies and also relevant domestic economic and financial policies. External stability in this Decision of 2007 encompasses both the current account and the capital account of the balance of payments, consistent with the members obligations under Article IV.

In my opinion, a new Decision would be helpful to clarify the extent to which financial stability and financial policies contribute to the notion of 'external stability'. This could also be the basis for the IMF to embrace more formally its role of global sheriff for financial stability.

In the words of the late Manuel Guitián, 'The IMF is primarily a surveillance institution',[12] in charge of the oversight of an international financial code of conduct. This code of conduct is a set of obligations that members must comply with according to the Articles of Agreement. The domain of surveillance has extended beyond macro-economic policies to encompass financial sector and structural issues.

Surveillance is a jurisdictional function, which has traditionally focused on the assessment of the exchange arrangements, the exchange rate and the balance of payments,[13] and which today focuses upon a wide range of economic policies, encompassing not only exchange rate, monetary and fiscal policies, but also

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[10] See Decision of the Executive Board No. 5392-(77/63) of 29 April 1977 as amended. This decision implemented the new Article IV of the IMF Articles of Agreement, which at the time was still in the process of being ratified (The Second Amendment was approved in April 1976 and became effective in April 1978).

[11] See Decision of the Executive Board of 15 June 2007, on Bilateral Surveillance of Member Policies, available at http://www.imf.org/external/np/sec/pn/2007/pn0769.htm#decision.

[12] See Guitián, The Unique Nature of the Responsibilities of the International Monetary Fund, IMF Pamphlet Series No. 46, 1992, p. 9.

[13] Guitián, The Unique Nature of the Responsibilities of the International Monetary Fund, IMF Pamphlet Series No. 46, 1992, p. 11. "The focus of obligation on the part of members centers on the point and the terms of intersection of their national economies with each other – that is the balance of payments, the exchange rate and the exchange regime".

financial sector issues, structural issues and institutional developments.[14] Surveillance entails a judgement on the part of the Fund, and as with any judgement, a degree of discretion is always involved. In the case of surveillance, the exercise of this 'judgement' is particularly complex, because of the interconnectedness between domestic and foreign economic policy, the interdependence amongst countries and the political and social consequences of some sensitive economic decisions.

Following the abandonment of the par value regime, the Second Amendment places the function of surveillance at the centre of the Fund's operations, at the core of the international monetary system. From being a virtually self-enforcing arrangement subject to strict rules, surveillance now becomes a function in which judgment is of the essence. Surveillance is no longer a rules-based regime but a 'discretion based regime'.[15]

The obligations of IMF members with regard to surveillance are spelt out in Article IV, Section 1 of the IMF Articles of Agreement reads as follows:

> Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services and capital among countries and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

(i) Endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
(ii) Seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not produce erratic disruptions;
(iii) Avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and
(iv) Follow exchange policies compatible with the undertakings of this Section.

Article IV Section 1 imposes obligations upon its members that are both positive and negative in character. The positive obligations are the ones described in Article IV, Section 1 (i), (ii) and (iv). The negative obligation is the one described in Article IV Section 1 (iii), which is written in rather forceful terms: 'avoid manipulating exchange rates'.

The first two obligations of Article IV Section 1 – (i) and (ii) – are formulated in soft terms. As Proctor points out, 'an obligation to co-operate with a view to achieving a particular objective, does not impose an obligation to achieve that

[14]See http://www.imf.org/external/np/exr/facts/surv.htm, see also Bergthaler/Bossu, Recent Legal Developments in the International Monetary Fund, EYIEL 1 (2010), pp. 391–404.

[15]See also Guitián, The IMF as a Monetary Institution: The Challenge Ahead, Finance and Development, September 1991, p. 38.

objective.'[16] Gianviti considers that these first two obligations – (i) and (ii) – are 'soft obligations', as opposed to the obligations in (iii) and (iv), which are 'hard obligations', even though the language of Section 1 (iv) is rather generic.[17] While the obligations in Section 1 (iii) and (iv) relate to external policies, where the Fund has greater jurisdiction, the obligations in Section 1 (i) and (ii) relate to domestic policies, where members have greater sovereignty.

The members are obliged to co-operate with the Fund by supplying all the information necessary to allow the Fund to perform effective bilateral surveillance, according to Article IV Section 3(b). The obligation to furnish information to the Fund 'as it deems necessary for its activities', is also recognised in Article VIII, Section 5.

Despite the emphasis that Article IV places upon exchange rate policies, in recent years, the practice of surveillance has given greater emphasis to domestic policies (the 'soft obligations' of Article IV, Section 1 (i) and (ii)), than to exchange rate policies (the 'hard obligations' of Article IV, Section 1 (iii) and (iv)).

Since Article IV imposes obligations upon members, sanctions can be applied in the case of breach of these obligations. However, 'there has not been a single instance in which sanctions have been applied or a report has been made for breach of obligation under Article IV'. This *de facto* transformation of Article IV Section 1 into a 'soft law provision' is reflected in the description of Article IV consultation with members as 'policy advice' (. . .) or 'policy dialogue'.[18]

Gianviti discusses the nature of the obligation of members under Article IV and the ambiguities in Article IV, Sections 1 and 3. The focus of the obligation relates to exchange rate policies; other policies (such as trade and investment policies) do not constitute 'an obligation under Article IV' even if they are an important element to assess exchange rate policies. However, he acknowledges that the practice of surveillance is expanding beyond the actual obligations of Article IV through the conduct of Article IV consultations. He warns against an undue extension in this practice: if surveillance is perceived more as a form of peer pressure than as compliance with obligations specified in the Articles of Agreement, this may lead to a dilution of its objectives.

The language of Article IV Section 1 reflects the 'labour pains' of the origins of this provision, which came to replace the legal certitude and simplicity of the original par value regime. The choice of verbs (endeavour, seek to promote,

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[16]See Proctor, *Mann on the Legal Aspect of Money*, (6th ed.) 2005, p. 562.

[17]See Gianviti, Evolving Role and Challenges for the International Monetary Fund, in: Andenas/ Norton (eds.), *International Monetary and Financial Law Upon Entering the New Millenium. A Tribute to Sir Joseph and Ruth Gold*, 2002, p. 46. He defines a "soft obligation as an obligation that does not require the achievement of a particular objective or even the exercise of best efforts or due diligence, but only a reasonable effort in light of all relevant circumstances. In contrast, soft law means that there is no obligation at all".

[18]Gianviti, Evolving Role and Challenges for the International Monetary Fund, in: Andenas/ Norton (eds.), *International Monetary and Financial Law Upon Entering the New Millenium. A Tribute to Sir Joseph and Ruth Gold*, 2002, p. 47.

fostering, follow), the introduction of a preamble, and what I would describe as a 'hesitant tone' in the new mandate, suggest that the drafters of the provision were unsure about the direction that the new regime would follow and did not want to preclude an eventual return to the regime that they had just abandoned.

Types of Surveillance

The Fund mainly carries out surveillance through its so-called 'Article IV consultations' with each individual member country.

In accordance with Article IV of the IMF Articles of Agreement, IMF staff hold annual bilateral meetings with officials from the member country. When an 'Article IV consultation' takes place, a Fund staff team (called an IMF 'mission') visits the country to collect information about macroeconomic policies (fiscal, monetary and exchange rate), the soundness of the financial system, and other relevant issues such as social, labour, and environmental policies as well as institutional developments. Following the review of these policies, the Fund team holds discussions with the authorities regarding the effectiveness of their economic policies as well as prospective changes for the domestic economy and the member's balance of payments positions. At the conclusion of these discussions, and prior to the preparation of the staff's report to the Executive Board, the IMF mission often provides the authorities with a statement of its preliminary findings. Once the IMF's Executive Board has discussed the staff report, they forward a summary of the discussion to the country's government. The conclusions of the report are only published if the country consents to do so. However, with the increase transparency of the IMF and its work in recent years, the summary of the Executive Board discussions for many Article IV consultations are published in Public Information Notices (PINs), which are available in the IMF website.

The evolving nature of the practice of surveillance has been made possible thanks to the ample room of interpretation granted to the Fund in the exercise of surveillance. Every 2 years, the IMF reviews the principles and procedures that guide its surveillance.

In addition to this 'bilateral surveillance', there is also 'multilateral surveillance', with the publication by the Fund of a World Economic Outlook Report and a Global Financial Stability Report twice a year. Another form of surveillance is 'regional surveillance', under which the IMF examines developments in regional areas, such as the European Union and the euro area.

The purpose of surveillance is to evaluate the appropriateness of a country's existing policies and at the same time to encourage the country to adopt new policies that enhance the smooth functioning of the international monetary system. IMF surveillance integrates the bilateral aspects of analysing the policies of individual countries with the multilateral aspects of examining the consequences of these policies for the operation of the system as a whole.

From Macro-Surveillance to Micro-Surveillance

IMF surveillance has evolved significantly over the last decades, with the increased attention to financial sector issues and policies being the main development in recent years. While surveillance in the past was typically focused on the jurisdiction over the exchange arrangements of members and macro-economic policies, surveillance nowadays also takes into account other issues, often involving the workings of the private sector ('micro' issues), such as good governance (both political and corporate governance), legal and institutional reform, bank restructuring, financial reform, etc.

Surveillance of national policies becomes more complex when countries embark in programs of trade and financial liberalization. The opening up of the economy raises important challenges and sets into motion a process of regulatory reform. In the 1970s the emphasis of surveillance was on the traditional macro-economic policies such as exchange rate, monetary and fiscal policies. In the 1980s, structural policies became more relevant, particularly in the aftermath of the debt crisis. At the beginning of the 1990s, the transition from centrally planned to market economies in countries in Eastern Europe and the former Soviet Union moved surveillance in the direction of further structural reforms, with emphasis on legal and institutional reform. In the late 1990s the financial crises in South East Asia, Russia and other emerging economies, suggested that financial reform and financial law reform should be the object of IMF surveillance. Following the crisis 2007–2009 the IMF should adopt a key role in the strengthening of banking and financial systems, in the prevention of future crises and in the development of appropriate tools and frameworks for the resolution of crises, on a cross-border basis. This broad scope of economic situations and policies has facilitated the evolution of surveillance over the years, being the most interesting development in the last two decades the emphasis given to financial stability and financial sector policies.

There is a widespread recognition in the aftermath of the crisis that surveillance must be strengthened to increase the Fund's ability to detect incipient financial tensions and vulnerabilities in international capital markets. The Fund has access to information about vulnerabilities in each country and therefore is in a unique position via the exercise of its functions (in particular surveillance and technical assistance) to monitor that Members have adequate supervision, regulation and resolution procedures and tools. If we need a global institution that can safeguard international financial stability, the Fund is best suited to undertake such role.

The need to provide effective surveillance of the financial system (a need which became pressing following the crises in the late 1990s), gave rise to the Financial System Stability Assessments (FSSAs), which the Fund carries out as part of the Financial Sector Assessment Program (FSAP), a joint IMF-World Bank initiative which was introduced in May 1999.[19] In an FSSA, IMF staff address issues of

[19]See Financial Sector Assessment Program (FSAP) at www.imf.org/external/np/fsap/fsap.asp; see also IMF Executive Board Review of the Experience with the Financial Sector Assessment

relevance to the function of surveillance, including risks to macro-economic stability stemming from the financial sector and the capacity of the sector to absorb macro-economic shocks.

In addition to the FSSAs, a key component of the FSAP are the Reports on Observance of Standards and Codes (ROSCs) which summarise the extent to which countries observe certain internationally recognized standards and codes.[20] The IMF has recognised twelve areas and associated standards as useful for the operational work of the Fund and the World Bank. These comprise accounting, auditing, anti-money laundering and countering the financing of terrorism (AMF/CFT), banking supervision, corporate governance, data dissemination, fiscal transparency, insolvency and creditor rights, insurance supervision, monetary and financial policy transparency, payment systems, and securities regulation.

ROSCs provide a focus to surveillance, and also facilitate performance accountability. ROSCs also provide a direction to programs of technical assistance by identifying the areas which the country must aim to improve or strengthen.[21] Finally, ROSCs highlight the close relationship between conditionality and surveillance, and contribute to clarifying the obligations inherent in the international code of conduct, which the IMF oversees.

While FSAPs and ROSCs inform Fund surveillance, they have, as a legal matter, been performed so far as technical assistance. Such activities have been voluntary for both the member and the Fund.[22] This should however change now, and these activities should be formally part of surveillance, i.e., an obligation for Members. Such change would not require amendment to the IMF Articles of Agreement.

In terms of crisis prevention, I have advocated before[23] that the IMF could take a step forward in its assessment of the stability and soundness of countries' financial systems (an assessment which has been greatly improved via the FSAP program and ROSCs) through the development of an internal rating system for countries' banking

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Program, 6 April 2005 (PIN No. 05/47) at www.imf.org/external/np/sec/pn/2005/pn0547.htm; the reports prepared by the World Bank under the FSAP are called Financial Sector Assessments (FSAs).

[20]See "Reports on Observance of Standard and Codes" at www.imf.org/external/np/rosc/rosc.asp.

[21]Gianviti, Evolving Role and Challenges for the International Monetary Fund, in: Andenas/Norton (eds.), *International Monetary and Financial Law Upon Entering the New Millenium. A Tribute to Sir Joseph and Ruth Gold*, 2002, p. 49.

[22]Gianviti, Evolving Role and Challenges for the International Monetary Fund, in: Andenas/Norton (eds.), *International Monetary and Financial Law Upon Entering the New Millenium. A Tribute to Sir Joseph and Ruth Gold*, 2002, p. 49; according to Gianviti, ROSCs "bridge the gap between technical assistance and surveillance". The FSAP reports and ROSCs "feed into surveillance, i.e., provide material which deepens the Fund's understandings of the member's circumstances".

[23]See Lastra, *Legal Foundations of International Monetary Stability*, 2006, chapter 14.

and financial systems akin to the CAMEL system in the USA.[24] CAMEL ratings are composite ratings that take into account capital adequacy, asset quality, management competence, earnings and liquidity. CAMEL ratings are unpublished as opposed to the ratings prepared and published by private rating agencies. CAMEL ratings are a supervisory technique, which can act as an instrument of 'crisis prevention' by helping identify problems early on (effective supervision needs to be based upon the best possible information). The information (about banks) in the USA is provided to the authorities through on-site examinations and reporting requirements. Supervisors have the duty of alerting or warning institutions perceived to be in trouble, prompting in some cases early corrective action or restructuring.

These proposed IMF ratings could also be composite ratings with regard to the safety and soundness of a country's banking and financial system and could be based upon the results of Article IV consultations, FSAP reports, FSSAs and ROSCs, and upon the data compiled by members in accordance with the Special Data Dissemination Standard or SDDS and the General Data Dissemination System or GDDS.[25] These ratings could help identify vulnerabilities (a function that is already performed to some extent by ROSCs and through the practice of surveillance) and, therefore, act as an instrument of 'crisis prevention'.[26]

The question of publication (on a voluntary basis) of these proposed IMF composite ratings is debatable. According to Article XII, Section 8, which governs the communication of views to members, the Fund may – by a 70% majority of the total voting power – decided to publish a report regarding its monetary or economic conditions and developments which directly tend to produce 'a serious

[24]In the US, following criticism of the General Accounting Office regarding the existent of divergent approaches and bearing in mind that the determination of the soundness of a financial institution is not an "exact science", the federal regulatory agencies adopted the Uniform Financial Institutions Rating System in 1978-79. For banks the rating system is commonly known as the CAMEL system.

[25]See http://www.imf.org/external/np/exr/facts/data.htm. The need for data dissemination standards has been highlighted by financial crises in which information deficiencies played a role. The standards for data dissemination consist of two tiers. The first is the SDDS which was established in 1996 to guide countries that have access, or might seek access, to the international capital markets. The second tier, the GDDS was established in 1997 to help countries provide more reliable data. It is open to all IMF members. Importantly, the GDDS is focused on improving statistical systems, whereas the SDDS focuses on commitments to data dissemination standards in countries that already meet high data quality standards. Both are voluntary, but once a country subscribes to the SDDS, observance of the standard is mandatory. Countries also agree to post information about their data dissemination practices on the IMF's external website on an electronic bulletin board known as the Dissemination Standards Bulletin Board, DSSB. Further, they must establish an Internet site containing the actual data, called a National Summary Data Page (NSDP), to which the DSBB is linked.

[26]Article VIII Section 5 imposes an obligation upon members with regard to the reporting of information to the Fund. However, the requirements of Article VIII Section 5(b), which place member 'under no obligation to furnish information in such detail about the affairs of individuals or corporations' would certainly be a hurdle to surpass, since countries would only provide this information on a voluntary basis. Another legal requirement to take into account is Article XII Section 8.

disequilibrium in the international balance of payments of members'. The IMF would need to balance the incentives for members to remain open and candid in their relations with the Fund with the need to provide valuable information to investors. Since there is no collateral in international sovereign lending (conditionality serves a substitute for collateral), the decision to support a troubled country or a country which appears to be heading for trouble needs to be based upon the best possible information. The IMF can provide credible and reliable information on the health of the borrower country's economic and financial institution.

As mentioned above, one can draw an analogy between the work that the Fund could undertake to certify and monitor that countries have adequate financial regulation, supervision and resolution standards and the work of the Financial Action Task Force with regard to AML/CFT standards.

Arminio Fraga, former Central Bank Governor of Brazil, suggested a different proposal. He wrote in 1996 that, the IMF should act as 'the permanent auditor of countries, which should voluntarily submit themselves to examination in order to lower their borrowing costs. Annual Article IV consultations could be supplemented by quarterly reviews that would enhance the credibility of the data released under the IMF's recent initiative [he refers to the Special Data Dissemination Standard] and thus help to reduce the costs of adjustment programs'.[27]

Any degree of protection justifies regulation and supervision, nationally and internationally. The greater the expected protection, the more justifiable regulation and supervision becomes. It then follows that any degree of international protection justifies strengthening international banking rules and enhancing surveillance of domestic bank supervisory and regulatory policies. In fact, this increased surveillance and enhanced transparency in banking and financial matters is needed to preserve international financial stability. Greater and closer surveillance over financial systems and the quality and adequacy of their supervision, regulation and resolution frameworks should be an essential component of an Article IV consultation. The FSAP program was a step forward in the Fund's efforts to gather appropriate information to assess the stability and soundness of the financial systems of member countries. This program should now become an obligation for members.

Conclusion

In this paper, I have argued that the IMF is the institution best placed to assume the role of global financial authority. The instruments that the Fund has at its disposal in the pursuit of the objectives granted to it by the IMF Articles of Agreement – in particular with regard to surveillance – make the institution particularly suitable to become a 'global sheriff' for financial stability.

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[27]See Fraga, Crisis Prevention and Management: Lessons from Mexico, Essays in International Finance 200 (October 1996), pp. 54–55.

In my opinion, a creative interpretation of Article I and Article IV of the IMF Articles of Agreement provides the legal basis for the Fund to expand its surveillance role into issues of financial stability.[28] The reference in Article I (i) to international monetary problems can be construed nowadays as a reference to international monetary and financial problems. The same can be said about the reference in Article I (vi) to the promotion of international monetary cooperation, as well as to the role granted to the IMF according to Article IV Section 3 (a) to 'oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article'.[29] Furthermore, IMF members according to Article IV Section 1 (ii) shall 'seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not produce erratic disruptions'.

This paper focused on the surveillance function of the IMF. I have not discussed in great detail here the need for international financial regulation (rule-making) nor have I discussed other functions that should also be coordinated at the international level, such as dispute settlement.

Postscript

On 22 February 2010, the IMF released a document entitled 'The Fund's Mandate – The Legal Framework' to accompany an earlier document, 'The Fund's Role and Mandate – An Overview', published on 22 January 2010.[30] The aim of this February 2010 document is to survey the constraints and flexibilities that exist under the current legal framework to expand the role of the Fund with regard to financial sector issues and to confer upon it a clear mandate for 'systemic surveillance', as a form of 'multilateral surveillance':

> Just as national regulatory oversight after the crisis is shifting from the risks in individual institutions to the risks in the financial system as a whole, the Fund's oversight too must shift from a sum of its parts (bilateral surveillance of countries) to the system as a whole (multilateral surveillance).[31]

[28]The alternative route of an amendment to the IMF Articles of Agreement is likely to be a lengthy and convoluted process, since it needs to be approved by the Board of Governors and it becomes effective when it has been ratified by three-fifths of the members, having eighty-five percent of the total voting power (and with the US holding 17% of the voting power – effectively a veto power – it may be subject to the whims of the US Congress).

[29]Financial stability as a concept is a relatively modern one, since other concepts were used in the past to describe this objective; the term macro-prudential supervision is even more contemporary.

[30]The document 'The Fund's Mandate – The Legal Framework' of 22 February 2010 is available at http://www.imf.org/external/np/pp/eng/2010/022210.pdf. The document, 'The Fund's Role and Mandate – An Overview' of 22 January 2010, is available at http://www.imf.org/external/np/pp/eng/2010/012210a.pdf.

[31]Ibid (document of 22 January 2010).

The Fund somehow appears to be struggling to try to sort out how the international financial system relates to the international monetary system (as well as differentiating between what is public and what is private). The February 2010 document claims that the Articles provide sufficient flexibility to accommodate reforms (with the limits imposed by Articles 31–33 of the Vienna Convention of the Law of Treaties[32]) and that the drafters of the Articles conferred upon the Fund 'enabling authority' in key areas that can facilitate an updated or expanded mandate for the Fund with regard to financial sector issues ('. . . the operational content of the Fund's mandate has been updated over time by Executive Board decision').[33] The document also acknowledges that the option of amending the Articles of Agreement would be a difficult one.

Annex

Vienna Convention on the Law of Treaties 1969,[34] Articles 31–33

Article 31. General Rule of Interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
   (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
   (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
   (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
   (b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
   (c) Any relevant rules of international law applicable in the relations between the parties.

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[32]'And while these powers [conferred upon the Fund] are often expressed in general terms, the degree to which their interpretation can evolve is limited by the plain meaning of the text, as supplemented by the *travaux preparatoires* (legislative history)'. See page 3 of document of 22 February 2010. See also Annex at the end of this paper.

[33]Ibid.

[34]Done at Vienna on 23 May 1969. Entered into force on 27 January 1980.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32. Supplementary Means of Interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) Leaves the meaning ambiguous or obscure; or
(b) Leads to a result which is manifestly absurd or unreasonable.

Article 33. Interpretation of Treaties Authenticated in Two or More Languages

1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.
2. A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.
3. The terms of the treaty are presumed to have the same meaning in each authentic text.
4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

No Ado About Nothing: Obama's Trade Policies After 1 Year

Andreas Falke

Introduction

Obama came to office during the worst financial and economic crisis since the Great Depression of the 1930s. Trade was not at the centre of this crisis, unlike the events of the 1930s, when the infamous Smoot–Hawley tariffs set in motion a spiral of protectionist moves by the major trading powers, deepening the global depression. This time, the protectionist responses were mild; the world trading system as codified in the WTO and sustained by increasingly global supply chains held up. No real challenge was mounted to the system of global and regional rules. However, the Doha Round of WTO negotiations continued to languish, and the Obama Administration did not give the negotiations a new impetus, which could have helped to bring the negotiations to a conclusion and could have instilled new confidence into the world economy.

Obama was elected as a Democrat, and as such has to be responsive to the protectionist sentiment among the rank and file of the party, in particular among labour unions. However, he did not bow to the protectionist wing of his party. His major economic policy advisers during his first 18 months in office were all supporters of openness, and there were no serious protectionist moves during the first year of his team. As a matter of fact, trade policy was simply not on the agenda of the administration. The administration has not come out with a clear template for how it will conduct trade policy, either multilaterally or regionally.

This is very unlikely to continue. Trade will be an important element in an economic recovery and in righting the massive imbalances in the global economy, where the USA will be forced to reduce its current account deficit. As the dollar is likely to remain weak or to be kept weak by the administration, an export offensive can be expected to be developed by economic policy-makers. Trade policy will have to be a critical ingredient of such an offensive, including a conclusion of the Doha Round. However, this will mean that the USA will pursue an aggressive

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_6, © Springer-Verlag Berlin Heidelberg 2011

market-opening strategy, and will not be satisfied with a minimal package. The second reason why trade policy cannot remain on the sidelines is that the most important bilateral relationship, the one with China, needs enhanced attention. The Chinese continue to peg their currency to the dollar, thus shielding themselves against the depreciation of the US currency and mimicking all devaluations vis-à-vis the currencies of other trading partners. Chinese exports have shown no sign of abating, so the day of reckoning will certainly arrive during Obama's first term, and this will spell a crisis situation in the world trading system. The third reason for greater attention to trade policy is the intersection with climate change policy. The climate change bills currently discussed in the US Congress all contain border measures to be instituted against imports from countries which do not take measures against climate change.

During his first year in office, Obama focused primarily on dealing with the financial crisis and the recession, and on his reform program, above all on healthcare reform. So although there is little to report currently on trade policy, this article will lay out a scenario for how the Obama Administration may respond to the very taxing challenges that will emerge in the trade policy arena. The prediction is that the calm in trade policy will be over soon.

First Steps: Trade Policy and the Response to the Financial Crisis

In response to the financial crisis, the Obama Administration in conjunction with the Federal Reserve and in continuation of the Bush Administration policies enacted a massive and globally coordinated fiscal stimulus and a coordinated monetary stimulus. The USA paid for this with a budget deficit unprecedented in peacetime of 10% of GDP, which will stay high during this decade. However, the measures returned the USA to a growth path of a projected 2.4% for 2010, although unemployment will remain high.[1] On the positive side of the economic downturn was a dramatic reduction of the current account deficit, which dropped from more than 6% to less than 3% of GDP in 2009, mostly due to declining imports. Also, the dollar depreciated after strengthening during the height of the crisis as a safe haven.[2] So the trade policy environment was benign. The USA was not under pressure, also because a cycle of beggar-thy-neighbour trade policies did not materialize.

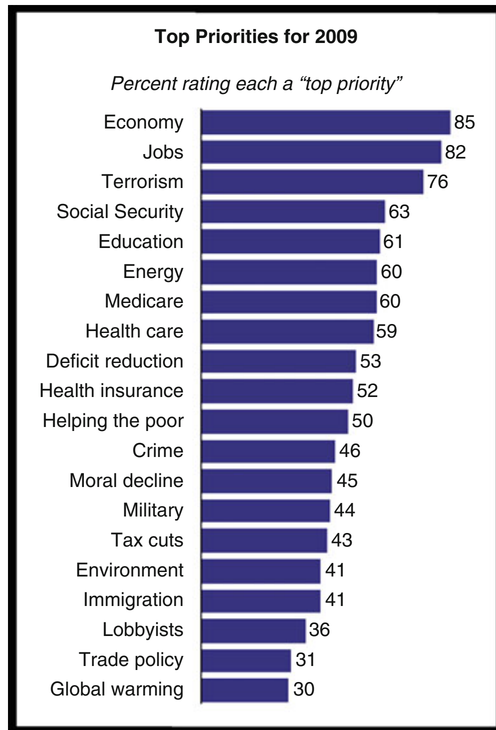
Trade policy did not play a prominent part in the early months of the administration. The critical appointments did not have a lot of resonance and went almost unnoticed. Obama's appointment as US trade representative, Ron Kirk, reflected the low priority of trade issues. As a former mayor of Dallas, he came with few trade

[1]For a good summary see Johnson, Testimony submitted to the Joint Economic Committee, hearing on "The Impact of the Recovery Act on Economic Growth", 29 October 2009, available at http://www.iie.com/publications/papers/paper.cfm?ResearchID=1320.

[2]Bergsten, The Dollar and the Deficits: How Washington Can Prevent the Next Crisis, Foreign Affairs 88 (Nov./Dec. 2009) 6, available at http://www.iie.com/publications/papers/paper.cfm?ResearchID=1312.

credentials. With his Texas background, however, he could be counted on to support continuing US membership in NAFTA, an issue that had briefly surfaced during the campaign when both Democratic candidates had voiced support for renegotiating the accord.[3] No political heavyweights were appointed to the trade portfolio. Domestically, all was quiet on the trade front and that spared Obama any conflict with US trade unions, which are the most protectionist group among the array of trade-oriented interest groups. Most congressional Democrats are equally sceptical of trade liberalization. The atmosphere of trade politics remained poisoned, and for Obama it was important not to spoil his relationship with congressional Democrats, particularly as there are more pressing issues such as health care and overcoming the economic crisis.[4] Public opinion fully underwrote this stance: Trade issues next to climate change enjoyed the least priority for Americans when Obama took office.

Political preferences of Americans, January 2009[5]



[3]Knowlton, Obama Doesn't Plan to Reopen Nafta Talks, New York Times, 20 April 2009, p. B3.

[4]Crook, Obama has to lead the way on trade, Financial Times, 22 December 2009, p. 9; Beattie, Legacy of bitterness and mistrust on Capitol Hill points to stasis on trade deals, Financial Times, 16 January 2009, p. 3.

[5]Pew Research Center for the People and the Press, Economy, Jobs Trump All Other Policy Priorities In 2009, 22 January 2009, available at http://people-press.org/report/485/economy-top-policy-priority.

But trade made it on the agenda by the fallout of the financial crisis. One aspect of the economic meltdown was the collapse of world trade. World trade in 2009 fell by 9%, the first drop since the Second World War. The fear was that countries would react by restricting openness.[6] The greatest danger was seen in a wave of WTO legal protectionism that would take advantage of the divergence between bound and applied tariffs. This divergence can be found in many Asian countries such as India, Indonesia and Thailand, but also in some Latin American countries and South Africa. In Latin America, for instance, bound average tariffs are between 25 and 35%, whereas the applied rate is only 10–12%.[7] There was heightened concern that those countries under the pressure of the economic downturn would raise their tariffs to the legally possible maximum of the bound rate, i.e. they would reverse their unilateral liberalization that they had enacted outside the WTO framework.[8] Some countries such as India did indeed pursue this path but only to a limited extent.

Protectionist signs were evident in many initiatives designed to counter the economic downturn. Economic stimulus programmes were designed to keep out foreign suppliers from public procurement.[9] The USA itself set a bad example with Buy-American provisions in the *American Recovery and Reinvstment Act* of 2009, which state that publicly funded projects must rely on US inputs, a set of provisions pushed by the US steel industry. It remains to be seen whether a clause that WTO law has to be observed will have any effect. Usually, procurement decisions in such programmes happen on the state and local level, where WTO law tends to be disregarded.[10] A protectionist potential is also contained in the bailout funds for the automobile industry on both sides of the Atlantic in terms of violating the WTO antisubsidy code. The bailout programme for the US automobile sector is the greatest industrial policy initiative in US history. Greater than a subsidy trade-war á la Airbus is the danger that the automobile sector just as the steel and shipbuilding sectors will be permanently excused from the WTO antisubsidy code.[11] In addition, there was also a noticeable rise in antidumping actions.

Because of these developments, there were enough reasons to be concerned about the direction of world trade in view of the severe economic downturn. So it came as no surprise that there were voices arguing for trade policy countermeasures to stem the possible tide of a new protectionism. In particular, there were calls to

[6]OECD, Keeping Markets Open, Policy Brief, April 2009, p. 2

[7]Cline, Trade, Finance, and the Global Recession, Peterson Institute for International Economics, p. 4, available at http://www.iie.com/publications/papers/cline0209.pdf.

[8]Sally, *New Frontiers in Free Trade. Globalization's Future and Asia's Rising Role*, 2008, pp. 102–110.

[9]Evenett, Keeping borders open during the global downturn: What are the options?, VoxEU, 28 January 2009, available at http://www.voxeu.org/index.php?q=node/2847.

[10]Hufbauer/Schott, Buy American: Bad for Jobs, Worse for Reputation, Institute for International Economics, Policy Brief 09-2, 2009.

[11]Brunel/Hufbauer, Money for the Auto Industry: Consistent with WTO Rules? Policy Brief, PF09-4, Institute for International Economics, February 2009.

conclude the Doha Round of trade negotiations that had faltered in summer 2008. These calls came from WTO Director Pascal Lamy as well as from European leaders, most loudly from British Prime Minister Brown. The conclusion of a new WTO accord was now justified as an antidote to growing protectionism, especially the legal protectionism, which exploited the difference between bound and applied tariffs. Other than crisis-induced protectionism, the conclusion of the Doha Round would also have sent a signal of confidence.

A final attempt to bring the Doha Round to a conclusion failed in August 2008. The USA was not willing to subscribe to a minimal package of liberalization. India and other emerging market countries were not willing to make substantial concessions in industrial market access, in part because they fear Chinese competition. Their offers basically consisted of converting applied rates to bound rates, cementing the status quo. This was too little for the USA to commit to a reduction of US agricultural subsidies. The USA was also unwilling to liberalize provision of services under Mode IV, as this implies freer movement of people and intersects with immigration policy. In the end, the issue of agricultural market access for US suppliers in India broke the camel's back.[12]

There were few signs that the Obama Administration would be willing or able to break the Doha stalemate. In its first statements, the Obama Administration echoed the stance of the Bush Administration: emerging market countries supposedly offered too few concessions on industrial and agricultural market access. In addition, administration officials complained about the absence of social and environmental standards as negotiating subjects.[13] All expectations that there would be a new impetus for finishing the round were dashed.

Trade Policy as Part of a Strategy for Economic Recovery and Correcting Global Imbalances

Despite the administration's passivity, there is every indication that an active trade policy could make an important contribution to economic recovery and righting the imbalances in the world economy. Already in early 2008, when domestic demand was first faltering in the USA, all of the feeble growth came from exports. Helped by a trade-weighted devaluation of the dollar by 25–30% since 2002, exports in 2007 and 2008 grew at an annual rate of 8%. Only the global economic downturn ended the US export boom.[14] It is a frequently held misconception that the USA has nothing to export except airplanes and weapons. But the economic reaction to a variation of

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[12]Blustein, *The Nine-Day Misadventure of the Most Favored Nations. How the WTO's Doha Round Negotiations Went Awry in July 2008*, 2008.

[13]Beattie, Obama signals tough stance on Doha, Financial Times, 2 February 2009, p. 4.

[14]Bergsten, Trade Has Saved America from Recession, Peterson Institute for International Economics, 30 June 2008, available at http://www.iie.com/publications/opeds/oped.cfm?ResearchID=969.

export shows that the USA can be competitive across a range of exports. Frequently those goods are not so visible, such as medical technology, pharmaceuticals, specialized electronics, optical, photographic and cinematographic equipment,[15] and especially services, where the USA has consistently run a surplus. The recurrent US trade deficits do not indicate a lack of competitiveness in general, although individual sectors such as automobiles may have competitiveness problems.

In macroeconomic terms, a trade deficit reflects a shortage of savings in the domestic economy and reliance on capital imports to finance the shortfall, or excessive spending that is financed by borrowing. Up to the financial crisis, households had been dissaving, encouraged by the massive increase in the prices of their assets, particularly real estate. In the first half of 2008, the US household saving rate dropped to 1.2%.[16] Also, the federal government had been and continues to be dissaving through running large budget deficits. The current account deficit, which is a larger indicator than the trade deficit, reached a record of 6.2% of GDP in 2006.[17] The current account deficit has been shrinking dramatically owing to the economic crash to less than 3%. But with an economic recovery, a return to the old patterns is seen as likely.[18] But such a level is not sustainable and is very risky. Such global imbalances were also an important context of the financial crisis, as the massive capital flows made such excesses possible. The financial sector as the crucial intermediary profited greatly from these capital flows because they allowed the generation of transactions and of fees and bonuses in the financial sector.[19]

With a return of the current account deficit to 6% of GDP, US foreign debt would grow from today's 30% of GDP to 70% in 2030, assuming a moderate budget deficit of 2–3%. With a continuation of budget deficits in the 10% range, the current account deficit could reach 15–25%, including a trade deficit of at least 8% of GDP. The annual cost of debt service would amount to $2.5 trillion. Such an outcome is highly unlikely, as the dollar would probably collapse and this would spell a serious recession. Nevertheless, budget consolidation and a rebuilding of private household savings are the order of the day.[20] This should automatically dampen imports, and as value of the dollar is likely to be lower, encourage exports.

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[15]For a list see Rosen, The Export Imperative, Testimony prepared for the Senate Finance Committee Subcommittee on International Trade, 9 December 2009, p. 8 et seq.

[16]See U.S. Bureau of Economic Analysis, National Economic Accounts, Personal Savings Rate 2004–2009, available at http://www.bea.gov/BRIEFRM/SAVING.HTM.

[17]Nanto/Ilias, U.S. International Trade: Trends and Forecasts, Congressional Research Service Report RL33577, November 2008, p. 14.

[18]Bergsten, The Dollar and the Deficits: How Washington Can Prevent the Next Crisis, Foreign Affairs 88 (Nov./Dec. 2009) 6, available at http://www.iie.com/publications/papers/paper.cfm?ResearchID=1312.

[19]Cline, Long-Term Fiscal Imbalances, US External Liabilities, and Future Living Standards, in: Bergsten (ed.), *The Long-Term International Economic Position of the United States*, 2009, pp. 11–33.

[20]Cline, Long-Term Fiscal Imbalances, US External Liabilities, and Future Living Standards, in: Bergsten (ed.), *The Long-Term International Economic Position of the United States*, 2009, pp. 24, 31.

An emphasis on exports as a crucial element of growth is also called for by the demise of the old growth model that relied on a prominent position of the financial sector and real estate activity. The US financial sector in its heyday generated 40% of corporate profits, which is unlikely to continue when the dominant position of financial institutions in the economy is diminished as appears to be the case owing to the crisis and Obama's banking reform proposals.[21] Dubious and highly risky financial transaction and securitization will not generate growth and jobs, only sustained export performance can do this. For this to happen, private investment in plants and equipment, which dropped to less than 10% of GDP, has to increase again. A continuation of past policies will lead to an erosion of living standards in the USA.

Although a lower exchange rate will go quite a way to reach this objective, it will also require an active export strategy and trade policy. The basic conditions for an export boom such as increasing productivity and structural change are in place.[22] The US economy has to operate under an export imperative, and the USA needs to develop an export culture. Currently, exports make up little more than 10% of GDP, as compared with 40% of the euro area. Only 4% of US companies export. Only 0.5% of all companies operate in more than one foreign country. Five hundred companies account for 60% of US exports. And companies with more than 500 employees, which constitute only 3% of exporting companies, account[23] for 70% of US exports. Especially small and medium-sized companies have to become more active in world markets. Measures could include improvement of an export-oriented infrastructure (transportation and ports), providing adequate export financing and information about export opportunities.

In the end, better market access will also be crucial, meaning that trade policy cannot be kept off Obama's agenda. It will be impossible to ignore it. Although some of the action will be channelled into enforcing US trade law and using instruments such as antidumping, it will be imperative to develop a strategy for trade liberalization. The question then is what will this strategy look like? In the past the USA has used multilateral, regional and unilateral approaches. Since the stagnation of multilateral negotiations, particularly free trade agreements (FTAs) have proliferated.[24] Currently the USA has FTAs with 17 countries, ten of which are with countries of the Americas, including NAFTA.[25] FTAs have been more ambitious than multilateral accords, including items such as environmental and labour provisions. Nevertheless, they have been very controversial because they had developing countries with lower social and environmental standards as

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[21]Banks Face Revolutionary Reform, Financial Times, 22 January 2010, p. 2.

[22]Hale, America is on the verge of an export boom, Financial Times, 11 December 2009, p. 13.

[23]Rosen, The Export Imperative, Testimony prepared for the Senate Finance Committee Subcommittee on International Trade, 9 December 2009, pp. 1–2.

[24]Schott, Confronting Current Challenges to U.S. Trade Policy, in: Bergsten (ed.), *America and the World Economy*, 2005, pp. 247–280.

[25]See U.S. Trade Representative, Free Trade Agreements, last updated on 2 June 2009, http://www.ustr.gov/trade-agreements/free-trade-agreements.

partners. For instance, the FTA with Colombia has been stalled over the treatment of union representatives in Colombia, with US trade unions using this situation to try to block congressional approval.[26] FTAs with developing and emerging market countries inevitably become immersed in domestic political controversy, mobilizing non-germane groups that have little stake in trade liberalization as such as labour unions and environmental groups. They may be therefore more difficult to pursue than the conclusion of the Doha Round.

Also, the administration has to prepare the domestic policy ground for trade policy initiatives. The atmosphere is poisoned on trade policy, so the administration has to work for a new consensus. This is imperative as any meaningful trade negotiations in the end require a domestic mandate or what is referred to as *trade promotion authority* (formerly fast-track). In the US constitutional system, the US Congress has responsibility for trade policy, so to ensure that the results of international negotiations are implemented domestically the US Congress (both chambers) has to give a mandate that sets certain parameters for the negotiations, but that ensures that an accord will be voted on in an up-or-down vote (without amendments) within a specified accelerated period of time. The last Trade Promotion Authority (TPA) ran out in 2007.[27] Whether the administration has the stomach – in view of a deep recession with high unemployment – to go for TPA remains to be seen. TPA is highly unpopular among unions and congressional Democrats allied with them. To not antagonize this constituency, the administration could delay TPA until the contours of a WTO accord are visible. It is possible that it may delay such a move until a second Obama term. One way to sweeten such a deal for critical constituencies would be side payments. The administration could initiate or increase so-called trade adjustment assistance, which gives benefits to workers displaced by imports owing to trade liberalization.[28] This could actually tie in nicely with a limited second stimulus package and emphasize the claim to assist US workers.

Given the political complexities of FTAs, a restart of the Doha Round may be the best strategy for the administration, short of an opportunity to revive the Free Trade Areas of the Americas, which seems out of the question for foreign policy reasons. Given the export imperative, it is highly unlikely that the administration would be content with a limited package as described above. The administration will certainly insist on a "big" package, guaranteeing improved market access for US industry and agriculture. In return, the US would have to be willing to limit agricultural subsidies, a major demand by emerging market countries such as Brazil and India. This could be feasible, if a low-value dollar continues to improve the competitiveness of US agricultural products, and budget pressures make a reduction

[26] Colombia Trade Spat Raises Fears for Doha, Financial Times, 16 April 2008, p. 6; Lobby for Colombia Trade Pact Casts a Wide Net, Washington Post, 8 April 2008, available at http://www.nytimes.com/2008/04/08/washington/08lobby.html.

[27] Schott, Confronting Current Challenges to U.S. Trade Policy, in: Bergsten (ed.), *America and the World Economy*, 2005, pp. 252 et seq.; Destler, *Renewing Fast-Track Legislation*, 1997, pp. 5–28.

[28] Rosen, Strengthening Trade Adjustment Assistance, Institute for International Economics Policy Brief, January 2008.

of subsidies necessary from a fiscal point of view. International conditions may have improved too, with major emerging market countries such as Brazil and India less affected by the financial crisis and more open to increased world market integration of their economies.

In the end, it is not up to the USA to restart the Doha Round. The USA and the EU may still be the dominant powers in the world trading system, but since the rise of the BRIC emerging market countries power is more dispersed in the WTO. Particularly Brazil and India have taken more active roles. China is passive, though, and Korea relies on an FTA strategy. The problem with the new actors is that they want to be players but not leaders. They are basically beneficiaries of the status quo and seem to assume that the system will go on indefinitely and that they do not have to make a contribution to its maintenance. But their rise has led to BRIC backlash in the developed world, and if they do not give more support to systemic factors (the benefits of improved rule-making, the costs of inaction and failed negotiations), the system may unravel under the defensive actions of developed countries, particularly the USA.[29]

However, the administration will have to do its domestic and international homework, and at the time of this writing in early 2010, any first steps in that direction are not even visible. It is very possible that the administration will delay any such steps until after 2012 – should Obama be re-elected – and rely in the meantime on the effects of a lower value of the dollar to stimulate exports. It would be the longest period of hibernation for US trade policy ever. Such hibernation will, however, not be helpful in dealing with the USA's most important and sensitive trade relationship, its relationship with China. And the issues with China cannot be pushed into the future as the exchange rate adjustment does not work in China's case.

The China Challenge

No other trading relationship is as important as the one with China. Trade with China has exploded since China's WTO accession. The value of China's exports grew from $18 billion (1980) to $1.4 trillion (2008). China's trade surplus rose from $9 billion (1990) to $297 billion (2008).[30] China is slated to pass Germany as the world's biggest export nation in 2010. The USA is China's biggest export market, taking 24% of all of China's exports, and China's exports to the USA have grown exponentially, making for a trade deficit of $266 billion in 2008. The trade deficit of the EU at $247 billion was almost as dramatic. A large number of Chinese exports come from foreign-funded enterprises, particularly from Hong Kong and Taiwan, which take advantage of China's low labour cost.[31]

[29]Schott, America, Europe, and the New Trade Order, Business and Politics 11 (2009) 3, pp. 1–22.

[30]Morrison, China's Economic Conditions, Congressional Research Service, 11 December 2009, p. 13.

[31]Morrison, China's Economic Conditions, Congressional Research Service, 11 December 2009, p. 14.

The trade deficit with China is of growing concern in the USA. Not only do unions and human rights and environmental campaigners complain about low labour, social and environmental standards which give Chinese producers an unfair comparative advantage, but the root cause of the magnitude of the trade deficit is seen in blatant Chinese exchange rate protectionism. Treasury Secretary Tim Geithner has called China a currency manipulator.[32] China pegs its currency to the dollar to keep the yuan from appreciating, thus keeping its exports competitive. Although China has since 2007 allowed an appreciation of its currency by 20%, this has been less than its productivity gains, and is only 15% in trade-weighted terms. Its current account surplus in 2008 was 11.3% of GDP. Its real exchange rate has been unchanged since 1998, and in the meantime it has amassed currency reserves of more than $2.2 trillion. This situation has led other Asian exporting nations to keep their exchange rates down, and has led their currencies appreciating sharply, similarly as the euro and Canadian dollar. To reach its equilibrium exchange rate, another 20–25% revaluation of the Chinese currency would be necessary, when the economic crisis is over.[33]

Should trade and current account balances on the precrisis level reappear, the US export-led growth strategy will falter, and the USA may be forced to take more drastic steps. The 1988 Trade Act requires the administration to report currency manipulation, and to start a number of corrective steps that could culminate in trade sanctions.[34] In 2004, various US manufacturing interests and US congressmen initiated a Section 301 unfair trade complaint under the 1974 Trade Act against China for currency manipulation. Between 2003 and 2006, a number of bills were introduced to levy an import charge on Chinese imports for currency manipulation. These actions were blunted by the administration and went nowhere, but could be revived at any time.[35]

So far the administration has relied on quiet diplomacy with the Chinese, but if trade deficits reappear while US unemployment remains high, the administration may not be able to withstand congressional pressure. One option could be a WTO complaint on the basis of GATT Art. XV (4), which keeps "contracting parties, by exchange rate action, [from] frustrating the intent of the provisions of the agreement." The chances for success are slight, as Art. XV (9) allows exchange controls and restrictions. Also the use of the WTO preamble, supporting balanced trade, would not be of much help. Most of the GATT articles regarding exchange controls relate to balance-of-payments difficulties.[36]

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[32]Calmes, Geithner Hints at Harder Line on China Trade, New York Times, 23 January 2009, available at http://www.nytimes.com/2009/01/23/business/worldbusiness/23treasury.html.

[33]See Wolf, Why China's Exchange Rate Policy Concerns US, Financial Times, 8 December 2009, p. 10; Goldstein/Lardy, *The Future of China's Exchange Rate Policy*, 2009.

[34]See Calmes, Geithner Hints at Harder Line on China Trade, New York Times, 23 January 2009, available at http://www.nytimes.com/2009/01/23/business/worldbusiness/23treasury.html.

[35]Hufbauer/Wong/Sheth, *US-China Trade Disputes: Rising Tide, Rising Stakes*, 2006, pp. 11–16.

[36]Hufbauer/Wong/Sheth, *US-China Trade Disputes: Rising Tide, Rising Stakes*, 2006, pp. 16–20.

More promising may be a case based on treating China's currency interventions as countervailable subsidies under the Agreement on Subsidies and Countervailing Measures (SCM). Such action is, however, fraught with difficulties and uncertainties. It will be difficult to prove the undervaluation. Scholarly opinion is divided, and it is even more difficult to ascertain a government financial contribution which is at the heart of a subsidy. The chances of a legal victory are slim.[37] Chinese currency manipulation and the massive trade deficit with China remains a sore for policy-makers in Washington and will continue to exert pressure for corrective trade action during the course of the Obama Administration. The opportunities for disrupting world trade are enormous as the ripple effects would be felt throughout the world trading system, forcing also action by the EU, which has voiced similar concerns.

In addition, other trade friction continues to weigh on Sino–US trade relations. The USA accuses China of not protecting intellectual property rights and of violating US patents, trademarks and copyrights in software, recorded entertainment products and pharmaceuticals, all areas where the USA enjoys comparative advantage. There are also issues about market access and investment.[38] Should concern about Chinese exchange rate policy and the trade deficit with China not abate, it is quite likely that trade relations with China will be very rocky in the second half of Obama's first term, with serious consequences for the world trading system.

Trade and Climate Change

The final challenge confronting the Obama Administration in the trade arena is the intersection of trade with climate change policy, i.e. the conception of border measures or border tax adjustment to avoid carbon leakage, the movement of carbon-intensive economic activities to jurisdictions with less stringent climate change regimes. The challenge is not only the WTO compatibility of such border measures, for which there are strong arguments, but issues of implementation and the need for finding international consensus,[39] but also the domestic political challenge in the USA. There is almost unanimous support for border measures, except in some trade policy circles which are aware that such measures could be dynamite for the world trading system. It will fall to the Obama Administration and its allies in Europe, where support for such measures is not as strong as in the USA, but is present nevertheless in countries such as France, to devise ways to make the emerging climate regime compatible with the world trade order.

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[37] Hufbauer/Wong/Sheth, *US-China Trade Disputes: Rising Tide, Rising Stakes*, 2006, pp. 20–23; Staiger/Sykes, Currency Manipulation and World Trade, NBER Working Paper No. 14600, 2008.

[38] Bergsten/Gill, *China. The Balance Sheet*, 2006, pp. 73–117.

[39] Ismer/Neuhoff, Border Tax Adjustment: A Feasible Way to Support Stringent Emissions Trading, European Journal of Economic Law 24 (2007), pp. 137–164.

This requires doing one's homework at the domestic front. Every legislative proposal or bill regarding climate change since the *Climate Change Stewardship Act* by senators McCain and Lieberman in 2003, including the *American Clean Energy and Security Act* (Waxman–Markey bill), which was passed by the House of Representatives in June 2009,[40] contains border measures. Such provisions have support in all political quarters, be it Republicans or Democrats, business or the environmental-NGO community. As for border measures, the Waxman–Markey bill mandates the creation of a pool of international reserve allowances, which importers of CO_2-intensive products from countries with insufficient climate change regimes have to purchase in order to import the product into the USA. Such a "shadow system" is not mandated before 2025, and the president has to certify its necessity. Obama has opposed mandating border measures at this point. The bill is vague on the specifics of implementation and the selection of countries and products. In addition, the bill allocates free allowances to CO_2-intensive industries which come under competitive pressure from foreign suppliers.[41] The Senate version of the bill will contain similar provisions.

The introduction of border measures may still be 15 years away, but it is certain that it will appear on the agenda much earlier, as developing countries are adamantly opposed to such measures. One way to diminish the explosiveness of the issue is to limit from the beginning the number of industries to be included in such measures and to restrict a border regime to a few highly CO_2-intensive products such cement, aluminium, pulp and paper, industrial gases, etc.[42] The pressure for the introduction of unilateral measures may be overwhelming in the US political system, particularly when the Senate passes a bill similar to the Waxman–Markey bill. The administration will therefore start working on containing this pressure and start international consultation, preferably with the EU and big emerging market countries.

Conclusion

Passivity, if not paralysis, seems to dominate trade-policy-making in Washington. The administration prefers to take a low-key approach to all trade issues. It was argued in this article that this cannot continue for the rest of Obama's term. He will

[40]House Passes Bill to Address Threat of Climate Change, New York Times, 27 June 2009, p. 1; House Panel Passes Limit on Greenhouse-Gas Emissions, Washington Post, 26 May 2009, p. 1; for a comprehensive overview of the bill see Congressional Research Service, Greenhouse Gas Legislation: Summary and Analysis of H.R. 2454 as reported by the House Committee on Energy and Commerce, 17 June 2009.

[41]Congressional Research Service, Greenhouse Gas Legislation: Summary and Analysis of H.R. 2454 as reported by the House Committee on Energy and Commerce, 17 June 2009, Part F, pp. 91–94.

[42]Grubb/Brewer/Sato/Heilmayr/Fazekas, Climate Policy, Allocation and Industrial Competitiveness, German Marshall Fund of the U.S., July 2009, p. 20.

have to address the issue of how to continue with the Doha Round, particularly as trade plays an important role in economic recovery and righting the imbalances in the world economy. The US economy may enter an export binge, and improved market access would be helpful.

However, even if the administration decides to tread lightly on multilateralism and not pursue a resumption of serious WTO negotiations, at the latest when the trade gap with China reappears, trade policy cannot be avoided any more. In addition, the trade pressures from climate change legislation will also appear on the radar screen of trade-policy-making.

What should the administration do? The best way would be a proactive approach that would combine restarting the Doha Round with tackling trade-related environmental problems in conjunction with the EU. A first step would be the elimination of tariffs on 43 climate-friendly products such as solar panels identified by the World Bank, and the establishment of an objective to phase out all restrictions and tariffs on green technology.[43] This will also put US and European biofuels subsidies and restrictions on the negotiating table, but on balance such a move may come much closer to reaching the big package desired by US industry. Europe should join the USA. Its leverage in trade policy is much smaller than in previous rounds given the growing influence of the emerging market countries such as Brazil and India.[44] The fact that the EU was left out of the final negotiations at the climate change summit in Copenhagen in December 2009 should be a warning for its trade-policy-makers. The USA needs the EU, but the EU may need the US even more in reframing multilateralism.

[43]Schott, America, Europe, and the New Trade Order, Business and Politics 11 (2009) 3, p. 18.

[44]Steven McGuire and Johan Lindeque (2010), 'Diminishing Returns to Trade Policy in the European Union', Journal of Common Market Studies, 48(5): 1327–1347.

Carbon Capture and Storage from the Perspective of International Law

Alexander Proelss and Kerstin Güssow

Introduction

It is generally accepted that the carbon dioxide (CO_2) concentration in the atmosphere should be reduced to limit its adverse effects on the earth's climate. Alongside strategies to reduce CO_2 emissions and improve the energy efficiency of industrial processes, technological approaches to climate change mitigation such as carbon capture and storage (CCS) are increasingly subject to debate. CCS represents one option in a larger portfolio of mitigation strategies for climate change. It consists of three distinct technological stages: separation, capture, and storage (also referred to as sequestration). CO_2 released by combustion processes in power plants is separated from other emissions and captured. After transport to a suitable storage location, CO_2 is isolated for extended periods to prevent its release into the atmosphere. The increasing relevance of CCS can be attributed to the fact that scientists suspect the existence of a huge number of geological formations on land and under the oceans with characteristics suitable for the storage, or geosequestration, of CO_2.

Nevertheless, CCS is a problematic mitigation strategy mainly for two reasons. First, once injected into the storage site, CO_2 can – at least potentially – escape from the reservoir via any variety of fissures in the geological formation, including the injection site itself. Although geological storage is generally considered to be

The authors thank Catherine Houghton for valuable comments on an earlier version of this paper.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_7, © Springer-Verlag Berlin Heidelberg 2011

secure,[1] the permanency of reservoirs – for example, depleted oil fields under the ocean – is not fully known. If CO_2 leaks from the reservoir, it could have extremely negative effects on the environment, especially on the marine environment in the case of reservoirs under the oceans. The potentially adverse effects of such leakage have not yet been completely researched, but it is not unlikely that impacts would reach far beyond local ecosystems.[2] The second point detracting from CCS is that an additional energy input of roughly 10–40% is needed to capture and compress the CO_2 compared with the operation of a power plant without a CCS system.[3] Regarding these uncertainties and limitations, CCS cannot be regarded as the sole strategy for combating climate change. Irrespective of whether its role is seen as a bridging technology to support a transition to an era of cleaner energy or as a fallback scenario, CCS must be thoroughly and reliably researched.

From a legal perspective, CCS must be measured against the requirements of international environmental law applicable to onshore and offshore activities. Notwithstanding the scientific uncertainties associated with this complex technology, CCS could become an economically sound instrument for meeting the intensified climate protection targets to which the EU and individual states committed themselves prior to the 2009 United Nations Climate Change Conference in Copenhagen.[4] These economic considerations exist owing to mechanisms contained in the 1997 Kyoto Protocol (KP)[5] to the 1992 United Nations Framework Convention on Climate Change (UNFCCC),[6] which provide economic incentives for achieving emission limits. Notwithstanding this, the main challenge to the establishment of a functioning international CCS regime is the diversity of aims pursued by the various legal instruments applicable to CCS.[7] In this paper, we analyze the specific legal requirements applicable to onshore and offshore CCS as well as the overarching principles of law governing climate change.

[1]According to an estimation by the Intergovernmental Panel on Climate Change (IPCC), up to 99% of the CO_2 is supposed to remain in the reservoir for more than 1,000 years; see IPCC Special Report on Carbon Capture and Storage, 2005, available at http://www.ipcc.ch/publications_and_data/publications_and_data_reports_carbon_dioxide.htm, Technical Summary, Section 5, p. 34.

[2]See IPCC Special Report on Carbon Capture and Storage, 2005, available at http://www.ipcc.ch/publications_and_data/publications_and_data_reports_carbon_dioxide.htm, Chapter 5, para. 5.2.

[3]IPCC Special Report on Carbon Capture and Storage, 2005, available at http://www.ipcc.ch/publications_and_data/publications_and_data_reports_carbon_dioxide.htm, Summary for Policymakers, Section 4, p. 4.

[4]Without prejudice to its position in international negotiations, the EU made a firm independent commitment to achieve at least a 20% reduction of greenhouse gas emissions by 2020 compared with the level in 1990. Ultimately, a reduction of emissions by 60–80% by 2050 compared with the level in 1990 is intended. See Council Document 7224/07 of 9 March 2007, Presidency Conclusions of the Council of the European Union, paras. 30, 32.

[5]2303 UNTS 148.

[6]1771 UNTS 107.

[7]OECD/IEA, *Legal Aspects of Storing CO_2*, 2005, p. 21.

Regulatory Framework at the International Level

Legal Requirements Applicable to Onshore Storage

In light of the principle of territorial sovereignty, the relevant legal framework applicable to onshore storage of CO_2 is almost exclusively provided by the national legal systems. In the absence of a comprehensive international regulatory framework for CCS, each individual activity is governed by existing rules, such as those for environmental impact assessment, property, oil and gas activities, pipelines, transport, and liability. Having said that, one must not ignore that the principle of territorial sovereignty is subject to certain legal limits. In this respect, a state is not entitled to pursue certain activities on its territory at the expense of the territorial integrity of the neighboring state or of the common spaces. This principle is firmly rooted in state practice and international jurisprudence,[8] and there is no reason to suggest that it does not apply to new technologies such as CCS.[9] The aforementioned duty and, in particular, the threshold from which a transboundary harm is to be considered "significant" is substantiated in the ILC Draft Articles on the Prevention of Transboundary Harm from Hazardous Activities.[10] Although these articles are not binding law by themselves, the correct view seems to be is that they offer an authoritative exposition of the existing law.[11]

Legal Requirements Applicable to Offshore Storage

United Nations Convention on the Law of the Sea

Because offshore CCS concerns a question of ocean law, reference to the 1982 United Nations Convention on the Law of the Sea (UNCLOS),[12] the constitution for the oceans, is mandatory.

[8]Trail Smelter Arbitration, *USA v. Canada*, RIAA III, pp. 1905, 1938 (1965); ICJ Advisory Opinion, *Legality of the Threat or Use of Nuclear Weapons*, ICJ Reports 1996, pp. 226 et seq. (241 et seq.); see also Principle 2 of the 1992 Rio Declaration on Environment and Development, 31 ILM 874 (1992) and Principle 21 of the Stockholm Declaration on the Human Environment, 11 ILM 1416 (1972).

[9]Note that with regard to the Draft Articles on the Prevention of Transboundary Harm from Hazardous Activities, the International Law Commission (ILC) decided not to specify the activities encompassed by these provisions since "[a]ny such list of activities is likely to be under inclusion and could become quickly dated from time to time in the light of fast evolving technology", YBILC 2001 II/2, pp. 149 et seq. (para. 4).

[10]YBILC 2001 II/2, pp. 146 et seq.

[11]Birnie/Boyle/Redgwell, *International Law and the Environment*, (3rd ed.) 2009, p. 141.

[12]1833 UNTS 3.

Impact of the Precautionary Principle

Part XII UNCLOS provides a marine protection regime which also applies to the seabed and its subsoil. It obliges all member states to protect and preserve the marine environment (Art. 192 UNCLOS) and to take all measures necessary to prevent, reduce, and control pollution of the marine environment from any source (Art. 194 (1) UNCLOS). Art. 1 (4) UNCLOS defines the term "pollution" as

> the introduction by man [. . .] of substances or energy into the marine environment [. . .] which results or is likely to result in such deleterious effects as harm to living resources and marine life [. . .].

In light of the potentially adverse effects on the marine environment, it is difficult to see why CCS should not be considered as pollution under this definition.

Prima facie, it seems that the question of how to deal with the scientific uncertainty which exists vis-à-vis the potentially negative impacts caused by physical leakage from a geological storage site must be considered as a test case for an application of the precautionary principle. Principle 15 of the Rio Declaration, which was adopted at the United Nations Conference on Environment and Development (UNCED) in Rio de Janeiro in 1992, contains the most widely known formulation of this principle:

> In order to protect the environment, the precautionary approach shall be widely applied by all States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.

Although the precautionary principle had not yet been developed when UNCLOS was adopted, the wording of some of its provisions, indeed, reflects a "precautionary spirit."[13] Art. 1 (1) (4) UNCLOS defines "pollution" not merely as acts that result in hazards to living resources and marine life, but extends it to such measures that are *likely* to have the aforementioned adverse effects. Furthermore, Art. 206 UNCLOS requires the state parties to conduct an environmental impact assessment whenever there are "*reasonable grounds* for believing that planned activities under their jurisdiction or control *may* cause substantial pollution of or significant and harmful changes to the marine environment." If these provisions are read in an isolated manner, it seems that an application of the precautionary principle militates in favor of a complete prohibition of offshore CCS activities, given that considerable adverse impacts on the marine environment cannot be excluded.[14]

However, such an isolated reading would ignore that CCS itself, aiming at the capture of CO_2 before its release into the atmosphere, is to be considered as a

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[13]Marr, *The Precautionary Principle in the Law of the Sea*, 2003, p. 52; see also Proelss, *Meeresschutz im Völker- und Europarecht*, 2004, pp. 81–84.

[14]IPCC Special Report on Carbon Capture and Storage, 2005, cf. http://www.ipcc.ch/pub/reports.htm, Summary for Policymakers, Section 22, pp. 12 et seq.

potential precautionary measure in climate change mitigation. Against this background, and keeping in mind its nature as a principle of law, the precautionary principle ought to be used to balance the risks arising out of offshore CCS activities with the potential advantages of this technology in combating global warming.[15] Consequently, CCS must not be undertaken on a commercial level until sufficient scientific clarity has been achieved that the potential benefits of these activities outweigh their potential environmental harm. Additionally, future commercial CCS activities must be subject to stringent risk assessment.[16] As a result, CCS is not generally prohibited under the UNCLOS regime if and to the extent to which it is conducted within the framework of balancing of values governed by a proper reading of the precautionary principle.

Which State Is Competent to Conduct Carbon Capture and Storage Activities?

A separate issue is linked to the regime of maritime zones established by the UNCLOS and deals with the question of which state(s) is/are entitled to conduct offshore CCS activities. Interestingly, this question has so far found only little attention in legal writings.[17] It is beyond doubt that with regard to reservoirs located within maritime areas subject to the territorial sovereignty of the coastal state, i.e., the internal waters, territorial sea, and archipelagic waters, it is up to the coastal state to decide whether third states may be granted access to the reservoirs concerned. Prima facie, the situation might be different with regard to the continental shelf. According to Art. 76 (1) UNCLOS, the continental shelf "comprises the seabed and subsoil of the submarine areas that extend beyond its territorial sea throughout the natural prolongation of its land territory to the outer edge of the continental margin, or to a distance of 200 nautical miles from the baselines from which the breadth of the territorial sea is measured where the outer edge of the continental margin does not extend up to that distance." Art. 77 (1) UNCLOS states that "the coastal State exercises over the continental shelf sovereign rights for the purpose of exploring it and exploiting its natural resources."

Whether or not CCS activities conducted on the continental shelf can be regarded as an exercise of sovereign rights in terms of that provision is subject to debate. On the one hand, a literal reading of Art. 77 (1) UNCLOS implies that the sovereign rights of the coastal state do not cover every economic use of the continental shelf, but only a use referring to the resources legally defined under

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[15] Güssow/Proelss/Oschlies/Rehdanz/Rickels, Ocean Iron Fertilization: Why Further Research is Needed, Marine Policy 34 (2010), pp. 911 et seq. (914 et seq.); see also Proelss/Krivickaite, Marine Biodiversity and Climate Change, CCLR (2009) 4, pp. 437 et seq. (444 et seq.); OECD/IEA, *Legal Aspects of Storing CO_2*, 2005, pp. 38, 41.

[16] Concerning ocean iron fertilization as a comparable mitigation strategy see Freestone/Rayfuse, Ocean Iron Fertilization and International Law, MEPS 364 (2008), pp. 227 (232).

[17] See Schlacke, Klimaschutz durch CO_2-Speicherung im Meeresboden – völkerrechtliche Anforderungen und europarechtliche Herausforderungen, EurUP 2007, pp. 87 et seq. (90 et seq.).

Art. 77 (4) UNCLOS.[18] If this is applied in an isolated manner, it seems that CCS activities would only be subject to the exclusive competence of the coastal state if these activities are inseparably linked to and used to facilitate the exploitation of oil and gas on the continental shelf (so-called enhanced oil and gas recovery). On the other hand, Art. 80, 60 (1) (b) UNCLOS provide coastal states with the exclusive right to construct installations for *any* economic purpose, as well as to authorize and regulate the construction, operation and use of such installations. Additionally, according to Art. 81 UNCLOS, the coastal state has the exclusive right to authorize and regulate drilling on the continental shelf "for all purposes," and Art. 85 UNCLOS emphasizes its right to exploit the subsoil by means of tunneling. If one merges the legal consequences deriving from the aforementioned provisions, and given the factual similarities with resource exploitation activities, it is submitted that the coastal state has the exclusive competence to regulate and conduct all CCS activities on its continental shelf.

The issue relevant here is even more complicated with regard to the areas beyond the limits of national jurisdiction, i.e., the high seas and the deep seabed ("area"). With a view to these common spaces, UNCLOS is based on the assumption that the regime of the high seas covers all activities carried out beyond the areas of national jurisdiction, irrespective of whether they are conducted in the water column or on the seabed, as long as UNCLOS does not contain any special rule to the contrary.[19] This conclusion militates in favor of accepting that CCS activities conducted in areas beyond the limits of national jurisdiction (if technically feasible) are covered by the principle of freedom of the high seas in terms of Art. 87 (1) UNCLOS.[20] Consequently, it seems that every state is legally entitled to store CO_2 in the seabed of the high seas. Having said that, it needs to be taken into account that although the regime of the deep seabed constitutes a special regime exclusively applicable to activities in the area, i.e., "all activities of exploration for and exploitation of, the resources of the Area" (Art. 1 (1) No. 3 UNCLOS), Art. 137 (1) UNCLOS prohibits any claim or exercise of sovereignty or sovereign rights over any part of the area in a general manner. Whether or not CCS activities conducted under the seabed beyond the outer limits of the continental shelf ought to be considered, owing to their spatial impact, as a claim or exercise of sovereignty or sovereign rights in terms of that provision (which would then have to be regarded as a *lex specialis* superseding the principle of the freedom of the high seas) is

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[18]Contra Purdy, Geological Carbon Dioxide Storage and the Law, in: Shackley/Gough (eds.), *Carbon Capture and its Storage*, 2006, pp. 87 et seq. (100), who argues that "the reference to the seabed and subsoil and their natural resources could be construed to cover things such as CO_2 storage."

[19]See Proelß, Marine Genetic Resources under UNCLOS and the CBD, GYIL 51 (2008), pp. 417 et seq. (430).

[20]See Purdy, Geological Carbon Dioxide Storage and the Law, in: Shackley/Gough (eds.), *Carbon Capture and its Storage*, 2006, pp. 87 et seq. (100 et seq.); Jenisch, Klimawandel und Seerecht, NuR 2008, pp. 227 et seq. (230), who correctly states that CCS activities cannot be regarded as "activities in the area" in terms of Art. 1(1) No. 3 UNCLOS, which would give rise to the jurisdiction of the International Seabed Authority.

unclear. The fact that the principle of freedom of the high seas also comprises the freedom to construct artificial islands and other installations (Art. 87 (1) (d) UNCLOS) suggests an answer to the negative.

Reference to Other Legal Regimes

The general obligations of Art. 192, 194 (1) UNCLOS concerning marine environmental protection are broad and must be further concretized. With regard to pollution by dumping, Art. 210 (1) UNCLOS only requires the contracting parties "[to] adopt laws and regulations to prevent, reduce and control pollution of the marine environment by dumping." According to Art. 210 (6) UNCLOS, these "national laws, regulations and measures shall be no less effective in preventing, reducing and controlling such pollution than the global rules and standards." The reference made to "global rules and standards" is generally understood as a reference to the 1972 Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter (London Convention – LC)[21] and the 1996 Protocol to the London Convention (London Protocol – LP),[22] which replaces the LC for its contracting parties.[23] Both instruments play a major role in the debate on the legality of offshore CCS activities.

London Convention and London Protocol

The concept of "dumping" is defined in Art. III (1) (a) LC and Art. 1 No. 4.1.1 LP as follows:

> (i) any deliberate disposal at sea of wastes or other matter from vessels, aircraft, platforms or other man-made structures at sea;
> (ii) any deliberate disposal at sea of vessels, aircraft, platforms or other man-made structures at sea.

Even if CO_2 introduced into the marine environment is not classified as "waste". it would still be classified as "other matter". Since it is intended to remain in the

[21] 11 ILM 1294 (1972).

[22] 36 ILM 7 (1997).

[23] It would not be uncontroversial to derive from Art. 210(6) UNCLOS that all (160) contracting parties to UNCLOS are automatically bound by the LC (86 contracting parties) and the LP (37 contracting parties) irrespective of a corresponding accession. Supporting this position is IMO Doc LEG/MISC/3/Rev.1 of 6 January 2003, Implications of the Entry into Force of the United Nations Convention on the Law of the Sea for the International Maritime Organization, p. 48. – Certainly the existence of global rules can be more easily affirmed in the case of the LC than the LP, which has less than half the number of signatories. It has been claimed that no state other than the member states of the LC and LP, representing about 72% of world tonnage, currently engages in dumping at sea in any significant form. If this is true, the assumption that the LC and LP are binding through an intermediary function of Art. 210(6) UNCLOS is defensible.

ocean, “disposal” appears to be occurring.[24] This alone, however, does not lead to the conclusion that CCS constitutes “dumping”. Art. III (1) (b) (ii) LC and Art. 1 (4) No. 2.2 LP contain an exception, under which

> ‘Dumping’ does not include: [. . .] (ii) placement of matter for a purpose other than the mere disposal thereof, provided that such placement is not contrary to the aims of this Convention.

However, since the goal of CCS is the storage of CO_2 for an extended period of time to prevent its release into the atmosphere, no purpose other than the mere disposal of CO_2 is being pursued.[25] Consequently, the question needs to be answered whether such dumping of CO_2 can be considered as being lawful. In this respect, different implementation mechanisms are presented in the LC and the LP: Although the LC principally outlaws the dumping of substances named in the annexes to the LC, the LP strengthens the regime by reversing the burden of proof. Here the dumping of all substances is forbidden unless an exception named in Annex 1 to the LP is applicable.

Annex 1 of the LP contains an exception which explicitly categorizes CO_2 streams derived from CO_2 capture processes for sequestration as “wastes or other matter” that may lawfully be dumped.[26] This exception, which was included in the LP on the occasion of the First Meeting of Contracting Parties to the London Protocol in 2006,[27] is restricted with the condition that a subseabed geological formation is used for disposal, that the matter disposed of consists overwhelmingly of CO_2 and that no other matter has been added for the purpose of disposal.[28] The term “overwhelmingly” was incorporated into the amendment, because the state parties were not able to agree on a quantitative limit for CO_2 contained in CO_2 streams. In particular, they did not accept a proposal by Greenpeace International to replace this term with a quantitative purity limit, recommending 99.9% CO_2 as a justifiable and achievable limit.[29] In the absence of clarification by the parties to the

[24]Rayfuse/Lawrence/Gjerde, Ocean Iron Fertilisation and Climate change: The Need to Regulate Emerging High Seas Uses, IJMCL 23 (2008), pp. 297 et seq. (312); see also OSPAR 04/2371.E, Annex 12, Report from the Group of Jurists and Linguists on Placement of Carbon Dioxide in the OSPAR Maritime Area, 2004, para. 20.

[25]Purdy/Macrory, Geological Carbon Sequestration: Critical Legal Issues, Tyndell Centre Working Paper No. 45, 2003, p. 32. This might be assessed differently for scientific experiments studying CCS.

[26]Annex 1, para. 1.8 LP. For a discussion of the legal situation under the LC see Friedrich, Carbon Capture and Storage: A New Challenge for International Environmental Law, ZaöRV 67 (2007), pp. 211 et seq. (221).

[27]See Resolution LP.1(1) of 2 November 2006, Amendment to Include CO_2 Sequestration in Sub-seabed Geological Formations in Annex 1 to the London Protocol.

[28]Annex 1, para. 4 LP.

[29]LP 1/6/2 of 8 September 2006, CO_2 Sequestration in Sub-Seabed Geological Formations: Consideration of Proposals to Amend Annex 1 to the London Protocol, Composition of CO_2 Streams for Sequestration in Sub-seabed Geological Formations: the Feasibility and Necessity for a Quantitative Limit on Purity, para. 12.

LP, the term should be understood as a call to minimize inevitable impurities in CO_2 streams during the CCS process.[30]

The CCS amendment to Annex 1 was preceded by fierce debates on its compatibility with the precautionary principle under Art. 3 (1) LP.[31] Delegations in favor of the amendment argued that CCS is one mitigation strategy in a portfolio of strategies to combat climate change and is, therefore, compatible with the precautionary principle. Delegations opposed to the amendment relied on the various scientific uncertainties regarding CCS and did not see this technology as compatible with the precautionary principle. Comparing these arguments, and keeping in mind what was stated above in respect of the legal nature of the precautionary principle, the suggestion made here to treat this principle as a tool to balance the advantages deriving from CCS as a means of climate change mitigation, on the one hand, and the potentially negative impacts on the marine environment, on the other, is gaining further support.

Concerning the potential transboundary movement of CO_2 streams, the Thirty-First Consultative Meeting of Contracting Parties to the London Convention and the Fourth Meeting of Contracting Parties to the London Protocol recently adopted Resolution LP.3(4), which amended Art. 6 LP. The amendment can be traced back to a Norwegian proposal[32] and enables parties to export CO_2 streams provided that an agreement has been entered into by the countries involved.

OSPAR Convention

At the regional level, the OSPAR Convention[33] establishes a legal framework to prevent and eliminate pollution from the maritime area of the Northeast Atlantic Ocean, including subseabed geological formations suitable for storage of CO_2.[34] The OSPAR Convention is generally considered to be one of the most important environmental law treaties ever concluded.[35] Referring to its precautionary, ecosystem and polluter-pays approaches, its objectives are even stricter than the aims of UNCLOS and the LC/LP. However, the OSPAR Convention must remain

[30] Stoll/Lehmann, *CO_2-Abscheidung und Speicherung im Meeresgrund*, 2008, p. 118.

[31] LC 28/15, Report of the Twenty-Eighth Consultative Meeting of Contracting Parties to the Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter 1972 and First Meeting of Contracting Parties to the 1996 Protocol to the Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter 1972, paras. 82 et seq.

[32] LC 31/5/1 of 23 April 2009, CO_2 Sequestration in Sub-seabed Geological Formations: CO_2 Sequestration in Transboundary Sub-seabed Geological Formations.

[33] Convention on the Protection of the Marine Environment of the North-East Atlantic, 22 September 1992, 32 ILM 1069 (1993).

[34] Art. 1 (a) OSPAR Convention; see also OSPAR 04/2371.E, Annex 12, Report from the Group of Jurists and Linguists on Placement of Carbon Dioxide in the OSPAR Maritime Area, 2004, para. 11.

[35] See Birnie/Boyle/Redgwell, *International Law and the Environment*, (3rd ed.) 2009, p. 394.

consistent with the LC and LP according to Art. 12 LP. Even though the OSPAR parties Finland, Portugal, and the EU are not parties to the LP, Annex II (on pollution by dumping and incineration) and Annex III (on pollution from offshore sources)[36] of the OSPAR Convention were amended in 2007 in a manner similar to the LP. The wording of the respective provisions is almost identical. The term "sequestration" used in the LP is replaced by the term "storage" in the OSPAR Convention, and a new subparagraph was added in each case, according to which CO_2 streams from CO_2 capture processes for storage "are intended to be retained in these formations permanently and will not lead to significant adverse consequences for the marine environment, human health and other legitimate uses of the maritime area."[37] To interpret and implement this provision, the OSPAR Commission adopted Decision 2007/2 on the Storage of Carbon Dioxide Streams in Geological Formations[38] and the Guidelines for Risk Assessment and Management of Storage of CO_2 Streams in Geological Formations.[39] However, both documents are silent on a proper understanding of the notion of "significant adverse consequences". It is submitted that recourse to the precautionary principle (cf. Art. 2 (2) (a) OSPAR Convention) is, again, mandatory to determine whether a certain adverse consequence is acceptable (i.e., "significant") in light of the objectives of the OSPAR Convention as well as the environmental threats posed by global warming. Storage of CO_2 in the water column is prohibited under the OSPAR regime.[40] The OSPAR framework also establishes a risk assessment tool applicable to CCS projects.

Climate Change Regulatory Framework

The primary instrument relevant to climate change is the UNFCCC and its KP, which entered into force in 2005. The UNFCCC aims to achieve a stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference in the climate system (Art. 2 UNFCCC), but strict requirements and obligations are largely lacking. When implementing the UNFCCC provisions, the parties shall be guided by, inter alia, a precautionary and sustainable – particularly an economically sustainable – approach.[41] This aim can

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[36]Note that Annex III only prohibits the placement from an offshore installation of CO_2 *not* arising from an offshore source; see OSPAR 04/2371.E, Annex 12, Report from the Group of Jurists and Linguists on Placement of Carbon Dioxide in the OSPAR Maritime Area, 2004, para. 27.

[37]Art. 3(2) (f) iv) Annex II and Art. 3(3) (d) Annex III OSPAR Convention.

[38]OSPAR 07/24/1-E, Annex 6, Decision 2007/2 on the Storage of Carbon Dioxide Streams in Geological Formations, Ref. §2.10c.

[39]OSPAR 07/24/1-E, Annex 7, OSPAR Guidelines for Risk Assessment and Management of Storage of CO_2 Streams in Geological Formations, Ref. §2.10d.

[40]OSPAR 07/24/1-E, Annex 5, Decision 2007/1 to Prohibit the Storage of Carbon Dioxide Streams in the Water Column or on the Sea-bed, Ref. §2.9b.

[41]Art. 3(3), (4) UNFCCC.

be achieved by both preventing greenhouse gas emissions from entering the atmosphere and removing greenhouse gases that have already been emitted. Therefore, the central norm of the KP, Art. 3 (1), provides for binding targets for industrialized states ("Annex I states") to ensure that their greenhouse gas emissions do not exceed their individually assigned limits and reduction commitments inscribed in Annex B to the KP. The KP does not contain obligations exceeding those of the UNFCCC for developing countries.

For Annex I states, Art. 2 (1) (a) KP lists policies and measures to be implemented in accordance with their national circumstances to achieve their quantified emission limitation and reduction commitments, including energy efficiency, the enhancement of sinks and reservoirs for greenhouse gases, research on and development of new forms of renewable energy, reforms in the relevant industrial sectors to limit or reduce emissions, and finally, CO_2 sequestration technologies.

Carbon Capture and Storage Under the Kyoto Protocol

Although the UNFCCC and particularly the KP describe a variety of mitigation measures, they do not specifically mention CCS. As regards the duty to meet the emission reduction commitments contained in Annex B, Art. 3 (3) KP accepts two overarching strategies to achieve the underlying objectives of the UNFCCC: the *removal* of greenhouse gases by *sinks*, on the one hand, and the *reduction* of emissions of greenhouse gases by *sources*, on the other. The classification of means of emission reductions as either sinks or sources is important for calculating the net emission reduction. Decisive for the achievement of individual reduction targets are the net changes in greenhouse gas emissions, i.e., the amount of greenhouse gases emitted from *sources* less the amount of emissions bound by *sinks*. If CCS is treated as a *removal* activity, CO_2 is considered as only having been emitted once. It is, therefore, counted in the national emission inventory, and a reduction by sources does not appear there. Implementation of the latter strategy, the reduction of emission of greenhouse gases by sources, is the principal objective of the KP.[42]

Both terms are defined in the UNFCCC. A sink is

> any process, activity or mechanism which removes a greenhouse gas, an aerosol or a precursor of a greenhouse gas from the atmosphere,[43]

whereas "source" means

[42]See also Dietrich, *CO_2-Abscheidung und Ablagerung im deutschen und europäischen Energieumweltrecht*, 2007, p. 240.

[43]Art. 1(8) UNFCCC.

> any process or activity which releases a greenhouse gas, an aerosol or a precursor of a greenhouse gas into the atmosphere.[44]

The KP specifies the removal of greenhouse gases by sinks, but limits the corresponding activities to land-use and forestry projects.[45] The KP would thus need to be amended to provide that submarine storage of CO_2 could be considered as a sink.[46] According to the 2001 Marrakech Accords,[47] activities under Art. 3 (4) KP, other than afforestation, reforestation, and deforestation, include only revegetation, forest management, cropland management, and grazing land management.[48] If this list of activities is considered exhaustive,[49] CCS in geological formations on land cannot be considered a form of land use in the wider sense and should, therefore, be seen as a sink. However, additional sink activities would have to be agreed by the Conference of the Parties to the UNFCCC. Even when referring directly to Art. 1 (8) UNFCCC, it is problematic to include CCS under the term "sink". The main criterion for this definition is its reference to greenhouse gases already released into the atmosphere. CCS aims to avoid, or at least minimize, the release of CO_2 into the atmosphere. However, if CCS is considered a *sink enhancement technology* according to the terms of the UNFCCC, the CO_2 physically formed during combustion of fossil fuels in power plants must be considered an emission, even though it has not been vented into the atmosphere. But the legal definition of Art. 1 (8) UNFCCC refers to the *atmosphere*, not to the capture of CO_2 from other origins, such as separation systems installed in power plants.[50] CCS therefore does not remove emissions from the atmosphere, but is to be considered as an emission reduction by source not necessitating an amendment to the KP. This conclusion is backed by Art. 1 (4) UNFCCC, which defines "emission" as

> the release of greenhouse gases and/or their precursors into the atmosphere over a specified area and period of time.[51]

Since the amount of captured and stored CO_2 does not find its way into the atmosphere, the outcome of CCS is a reduction in emissions.

[44] Art. 1(9) UNFCCC.

[45] Art. 3(3) and (4) KP.

[46] Friedrich, Carbon Capture and Storage: A New Challenge for International Environmental Law, ZaöRV 67 (2007), pp. 211 et seq. (213); Johnston/Parmentier/Krueger, Ocean Disposal/Sequestration of Carbon Dioxide from Fossil Fuel Production and Use: An Overview of Rationale, Techniques and Implications, Greenpeace Research Laboratories, Technical Note 01/99, p. 42.

[47] FCCC/CP/2001/13/Add.1 of 21 January 2002, Decisions 2/CP.7 to 14/CP.7.

[48] FCCC/CP/2001/13/Add.1 of 21 January 2002, p. 59, Decision 11/CP.7, Land use, land-use change and forestry, Annex: Definitions, modalities, rules and guidelines relating to land use, land-use change and forestry activities under the Kyoto Protocol, para. 6.

[49] Hohmuth, *CO_2-Abscheidung und Speicherung im Meeresgrund*, 2008, p. 219.

[50] Similarly Bode/Jung, Carbon Dioxide Capture and Storage (CCS) – Liability for Non-permanence under the UNFCCC, HWWA Discussion Paper No. 325, p. 6; Dietrich, *CO_2-Abscheidung und Ablagerung im deutschen und europäischen Energieumweltrecht*, 2007, p. 241.

[51] Art. 1(4) UNFCCC.

Despite the fact that emissions released into the atmosphere from CCS-equipped sources are significantly reduced when compared with conventional power plants, power plants equipped with CCS technology remain sources in terms of the UNFCCC and KP. Even though approximately 90% of the CO_2 produced is separated by postcombustion decarbonization,[52] and as much as 99.5% of CO_2 can be captured using an oxyfuel technology,[53] the CO_2 produced during the combustion process cannot be completely removed.[54] Furthermore, the individual steps in the CCS process – capture, transport, and injection – all constitute sources of emissions on their own because of the risk of leakage during the process.[55]

Emission reduction targets must, first and foremost, be fulfilled on the territories of Annex I states. In addition, to accommodate differing political and economic contexts, the KP also provides three flexible mechanisms to achieve greenhouse gas reductions outside the territory of the Annex I state concerned. Joint implementation (JI) allows two Annex I states to cooperate in implementing a greenhouse gas reduction project in either of the two states. The clean development mechanism (CDM) refers to emission reduction projects in non-Annex I states, providing rules for transferring the achieved emission reduction to an Annex I state. The third mechanism, which is, unlike the two aforementioned instruments, not project-based, is international emission trading (IET). In accordance with these economic incentives, there are two possibilities for using carbon credits derived from CCS activities under existing international climate change legislation. First, a power plant using CCS technology receives a set amount of carbon credits for trading on the basis of the total amount of CO_2 produced, encompassing not only the effectively released CO_2, but also the captured and stored CO_2. Second, bilateral CCS projects are considered project-based mechanisms in terms of the KP and generate carbon credits by preventing emissions.

Flexibility Mechanisms

International Emission Trading

Amending national reduction targets, IET is one of the economic instruments which seek to balance the interests of industrialized countries and developing countries

[52]Kessler/von Eysmondt/Merten, Nutzung von CO_2 aus Rauchgasen für chemische Synthesen, Chem.-Ing.-Tech. 64 (1992), pp. 1075 et seq. (1076).

[53]Much, Legal Aspects of Carbon Capture and Storage Technologies, in: Rodi (ed.), *Between Theory and Practice: Putting Climate Policy to Work*, 2008, pp. 123 et seq. (125); Supersberger/Esken/Fischedick/Schüwer, Carbon Capture and Storage – Solution to Climate Change, KyotoPlus Paper, 2006, p. 4.

[54]Note that Annex A to the KP enumerates a number of source categories. In the sector “energy” it refers to fuel combustion by energy industries and industrial processes, thus power plants.

[55]IPCC, Guidelines for National Greenhouse Gas Inventories, 2006, Volume 2, Chapter 5. Table 5.1 shows the categories in which those emissions are reported.

under the KP. Art. 17 KP merely accepts emission trading schemes as mechanisms to achieve greenhouse gas reductions, but does not establish such a scheme by itself. Further concretization on the national and/or regional level is thus mandatory. To achieve the obligations accepted under the KP, a company-level emission trading scheme targeted to the effective actors is considered to contribute to the reduction targets of the KP in the most effective way.[56] Under a classic emission trading scheme ("cap and trade"), the competent authority sets a limit ("cap") on the total amount of a pollutant that can be emitted. It then issues emission permits to companies, which are obliged to hold allowances or credits, respectively, in an equivalent number representing the right to emit a specific amount of pollutant. If a company needs to increase its emission allowance, it must buy credits from other companies who pollute less ("trade"). In the EU, a European directive establishing a scheme for greenhouse gas emission allowance trading within the European Community entered into force in October 2003.[57] The European Union Emission Trading Scheme (EU ETS) obliges member states to develop plans for achieving their national reduction targets. This directive is a basic part of the EU's climate protection strategy intended to fulfill its obligations under the KP.

Captured and stored CO_2 emissions can be part of the EU ETS, although they are not considered emissions in terms of the EU ETS.[58] The EU ETS Directive requires the surrender of emission trading allowances for any leaked emissions. Although an "opt-in" option exists for CCS projects during the second phase of the EU ETS (2008–2012),[59] all stages in the CCS process, from capture to transport to storage, will be integrated into the EU ETS (and considered a category of activities under Annex I of the EU ETS Directive) by 2013.[60] This means that the provisions of the EU ETS Directive will then apply to each individual stage and not just to CCS as a whole. CO_2 captured, transported, and stored is not classified as emitted according to the regulatory framework created in the CCS Directive (see below), and thus no surrender of emission certificates is required.[61] Emission trading allowances are currently allocated by alienation and auction. It has been emphasized, especially for capture, transport and storage of CO_2, that the free allocation of trading allowances should be ended by 2013.[62]

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[56]See Burgi, Die Rechtsstellung der Unternehmen im Emissionshandelssystem, NJW 2003, pp. 2486 et seq. (2487).

[57]Directive 2003/87/EC of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, OJ 2003 L 275/32.

[58]This principle was established in the 2006 IPCC Guidelines for National Greenhouse Gas Inventories, Volume 2: Energy, Chapter 5, para. 5.3.

[59]Art. 24 EU ETS Directive.

[60]Directive 2009/29/EC of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading system of the Community, Annex 1, OJ 2009 L 140/63.

[61]Art. 12(3a) EU ETS Directive.

[62]Art. 10a(1) EU ETS Directive.

Project-Based Mechanisms

Industrialized countries are allowed to realize parts of their reduction targets by implementing emission reduction projects either in developing countries under Art. 12 KP (CDM) or in cooperation with other Annex I states under Art. 6 KP (JI). Using CDM, an Annex I state engages in a project in a non-Annex I state "to assist Parties not included in Annex I in achieving sustainable development and in contributing to the ultimate objective of the Convention."[63] Such projects are designed to reduce emissions and often concern energy efficiency or renewable energies. Typical forms of engagement for Annex I states include technology transfer and financing of projects. The Annex I state receives credit for an additional emission reduction in the form of a tradable certified emission reduction (CER) certified by the CDM Executive Board.[64]

Based on JI, an Annex I state engages in financing a project to reduce emissions in another Annex I state. The investing state buys and is assigned reduction units from the foreign reduction project. The financing state receives a credit which this state can use toward achieving its own reduction targets. Within the EU, the so-called Linking Directive[65] includes JI and CDM in the EU ETS, making these project-based instruments accessible to companies at the European level. Both instruments, JI and CDM, differ from the "cap-and-trade" principle of emission trading in that they require the development of baseline and counting methodologies.

Joint Implementation

The potential for JI projects within the EU is limited because of the counting methodology provided in Art. 11 b (2) EU ETS Directive. For greenhouse gas reductions to be counted within the EU ETS, no other emission reduction units may be contributed.[66] Thus, credits for achieved reductions cannot be used twice, that is, both within the EU ETS and as a unit of JI. As it is obligatory that all reductions be counted within the EU ETS, any potential benefits from a JI project would be forfeited. The sole application where a CCS project can be beneficially realized within the JI mechanism is among non-EU Annex I states, where no emission trading scheme exists, e.g., Russia.

[63] Art. 12(2) KP.

[64] FCCC/KP/CMP/2005/8/Add.1 of 30 March 2006, pp. 8 et seq., Decision 3/CMP.1 of the Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol on its first session of 28 November to 10 December 2005.

[65] Directive 2004/101/EC of 27 October 2004 amending Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community, in respect of the Kyoto Protocol's project mechanisms, OJ 2004 L 338/18.

[66] Until December 2012 emission reduction units may be issued if an equal number of allowances is cancelled by the operator of that installation, Art. 11b(3), (4) EU ETS Directive.

Clean Development Mechanism

Concerning CCS, the technical potential for CO_2 to be captured from industrial activities is estimated as very high in non-Annex I states.[67] Additionally, rapidly industrializing countries may use more fossil fuels to meet their increasing energy demands, which leads to an increase in greenhouse gas emissions.[68] Because non-Annex I states are not required to meet specific emission reduction targets, CCS could be an appropriate tool for mitigating this increase, although there is concern that this could shift attention away from the development of sustainable, long-term solutions.

So far, neither the KP nor any decision part of the Marrakech Accords has explicitly referred to CCS. As the CDM Executive Board decides on the acceptability of individual CDM projects on the basis of guidelines released by the parties to the KP, the first idea might be to include CCS in those guidelines. But at the 2006 Conference of the parties (COP) to the UNFCC, the parties stuck to conflicting political positions and consequently failed to reach a decision on accepting CCS under the CDM.[69] At the forefront in this debate is the question of whether CCS projects are at all compatible with the KP as the underlying legal instrument . As stated above, Art. 2 (a) (iv) KP establishes an obligation for states parties to research on, promote, develop and increase the "use of, new and renewable forms of energy, of CO_2 sequestration technologies and of advanced and innovative environmentally-sound technologies." This provision does not create a hierarchy between sequestration techniques, renewable energies, and environmentally sound technologies, indicating that none of these possible measures is seen as the best measure for achieving the objectives of the KP. Therefore, the KP recognizes measures such as CCS and encourages Annex I states to use it. Additionally, the Marrakech Accords do not include a ban on CCS usage as they do for emission reductions generated by nuclear facilities.[70] Thus, CCS can be assumed to be compatible with the KP,[71] although the guidelines have not been extended to it until now, not even at the UNFCCC Conference in Copenhagen in December 2009. However, to be accepted by the Executive Board, a baseline and monitoring

[67]See Philibert/Ellis/Podkanski, *Carbon Capture and Storage in the CDM*, 2007, p. 12.

[68]Hohmuth, *CO_2-Abscheidung und Speicherung im Meeresgrund*, 2008, p. 244.

[69]The positions ranged from either stressing the importance of fossil fuels for development and therefore regarding CCS as a modern perspective to use fossil fuels, or stressing environmental and technical difficulties and uncertainties; see FCCC/KP/CMP/2006/3, Report on the workshop on carbon dioxide capture and storage as clean development mechanism project activities, para. 30; FCCC/KP/CMP/2006/MISC.2 of 15 September 2006, Consideration of carbon capture and storage as clean development mechanism project activities.

[70]FCCC/CP/2001/13/Add.2 of 21 January 2002, p. 20, Decision 17/CP.7 Modalities and procedures for a clean development mechanism as defined in Article 12 of the Kyoto Protocol.

[71]Similarly UNFCCC/CCNUCC, Executive Board 50, Draft Annex 1, Implications of the Inclusion of Geological Carbon Dioxide Capture and Storage as CDM Project Activities, p. 50.

methodology for the project must be developed which demonstrates, in particular, the additionality of any emission reduction.[72]

European Regulatory Framework

Bearing in mind the EU's commitment to achieve at least a 20% reduction in greenhouse gas emissions by 2020 as compared with the level in 1990,[73] the European Parliament and the Council of the European Union adopted a directive on the geological storage of CO_2 in April 2009 (CCS Directive).[74] Within its "Action Plan for Energy Policy" of March 2007, the European Council explicitly referred to CCS as a low-emission energy technology at the same level as renewable energies and energy efficiency.[75] The CCS Directive stresses the aim of CCS to serve as a bridging technology which "should not lead to a reduction of efforts to support energy saving policies, renewable energies and other safe and low carbon technologies, both in research and financial terms."[76] Recitals (12) to (14) of the CCS Directive refer to the legal status of CCS at the international level, thus to the LC/LP and the OSPAR Convention.

The CCS Directive applies to onshore geological storage of CO_2 on the territories of the member states as well as to subseabed storage on their continental shelves.[77] Similar to the situation under the OSPAR Convention, it prohibits storage of CO_2 in the water column[78] owing to the potentially high environmental risks involved.[79] A strict and detailed system to permit exploration of potential storage sites and to permit storage itself is provided in the form of a monitoring scheme. All steps associated with issuing and withdrawing storage permits include reference to risk assessment, using the term "significant irregularity" or the term "significant risk," which are both defined in Art. 3 CCS Directive.[80] Against this background, it is justified to conclude that the CCS Directive essentially absorbs

[72]See UNFCCC, Executive Board 39, Annex 10, Tool for the Demonstration and Assessment of Additionality, Version 5.2.

[73]Council Document 7224/07 of 9 March 2007, Presidency Conclusions of the Council of the European Union, para. 32.

[74]Directive 2009/31/EC of 23 April 2009 on the geological storage of carbon dioxide, OJ 2009 L 140/114.

[75]Council Document 7224/07 of 9 March 2007, Annex I, European Council Action Plan (2007-2009), Energy Policy for Europe (EPE), para. 4.

[76]CCS Directive, Recital 4.

[77]Art. 2(1) CCS Directive.

[78]Art. 2(4) CCS Directive.

[79]Doppelhammer, Richtlinienvorschlag der Europäischen Kommission zur Speicherung von Kohlendioxid, ZUR 2008, pp. 250 et seq. (251).

[80]Art. 3 No. 17 and 18 CCS Directive.

the regulatory approach of the aforementioned international law instruments relevant to CCS.

To avoid double regulation, the CCS Directive modifies a number of other directives dealing with environmental risks connected to CCS.[81] In particular, the CCS Directive adapts the Environmental Liability Directive (ELD)[82] so that it applies to the geological storage of CO_2. Thus, in addition to the provisions of the CCS Directive, the ELD covers damage to objects which are protected by its terms, such as protected species, natural habitats, water, and land. In contrast, damage to the climate caused by CO_2 leakage is covered by the EU ETS Directive (and, arguably, not by the ELD), as it requires surrender of emission trading allowances for any leaked emissions (cf. Annex I EU ETS Directive). With the exception of the issue of liability, the CCS Directive does not otherwise refer to the EU ETS. Consequently, the inclusion of CCS in the EU ETS and, therefore, the economic approach to CCS is governed by the terms of the EU ETS Directive exclusively.

Conclusion

Under the pertinent rules of the law of the sea, subseabed storage of CO_2 may lawfully be undertaken, provided that the competent authorities respect their duty to conduct risk assessments in the verification stage regarding the admissibility of the projects in question. The benefits and advantages of CCS as a climate mitigation strategy must be balanced against the objectives of the environmental protection regimes created by the respective legal instruments, in particular the UNCLOS, the LC and LP, and the OSPAR Convention. Also, under the UNFCCC and the KP, CCS is not generally prohibited. On the contrary, it is to be considered as an emission reduction by source, and CO_2 sequestration is one of the strategies mentioned by the KP to meet the emission reduction targets contained therein. The three flexible mechanisms of the KP are generally suitable to deal with CCS. This is so notwithstanding the fact that the potential of JI projects within the EU is limited, and that CDM requires baseline and monitoring methodologies applicable to an individual CCS project to be adopted by the CDM Executive Board. As a result, the economic profitability of CCS is backed by the regulatory framework of climate change legislation, as long as the potential of CCS as a climate mitigation measure outweighs the sectoral environmental objectives pursued with the legal instruments applicable to onshore and offshore storage.

[81] See Art. 31 et seq. CCS Directive.

[82] Directive 2004/35/EC of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage, OJ 2004 L 143/56.

Biofuels and WTO Law

Wolfgang Weiß

Introduction

Climate change and energy dependence have placed alternatives to fossil energy at the centre of public perception in industrialized countries. Hence, biofuels became an ever more important issue on their political agenda, leading to an increase in demand and global trade. Applying the global trade order of the WTO to biofuels, however, raises several problems. As there is no specific trade regime for biofuels, they have to be treated according to the general rules. This necessitates first determining in detail which WTO disciplines and rules apply. The debate about how to apply WTO rules to the biofuels sector gained momentum with a famous International Food & Agricultural Trade Policy Council report written among others by *Robert Howse*.[1] The determination of the applicability of WTO rules partly depends on the classification of biofuels, which, however, is not uniform since ethanol – as it is produced from agricultural feedstock – is seen to be an agricultural product, whereas biodiesel is perceived as a chemical, and thus an industrial good in the tariff schedules. This difference engenders different legal frames applicable not only with regard to tariffs (the difference is considerable [2] all the more as in the Doha Round the tariff reduction formula envisaged for industrial goods is more ambitious than that for agricultural goods) but also with regard to national subsidy schemes that can be applied, because in the case of ethanol the Agreement on Agriculture (AoA) also has to be considered. The application of the AoA impacts on the assessment of subsidies as the AoA has particular rules in addition to the template of rules in the Agreement on Subsidies and Countervailing

[1]Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006.

[2]The EU tariff on ethanol is around 60% (depending on the price of ethanol); on biodiesel it is 6.5%.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_8, © Springer-Verlag Berlin Heidelberg 2011

Measures (SCM). Even beyond that, one could contemplate attributing all biofuels to the new category of environmental goods currently being discussed in the Doha Round. The talks insofar aim for complete, fast-track liberalization of global trade.[3] The classification as environmental goods would help establish a global biofuels market besides the reduction of tariffs and agricultural subsidies.

Second, once the applicability of a particular WTO regime of disciplines has been clarified, as is the case, e.g., with regard to certification of biofuels or the adoption of sustainability standards which has to be done in conformity with Article I, III GATT, biofuels cause complex issues in their application. There are a great many possible domestic regulations and standards which may work as impediments to biofuel trade and need to be justified under WTO disciplines. Biofuels involve questions such as the lawfulness of unilateral sustainability requirements for import clearance or placing them on the market, the lawfulness of subsidies for biofuels' preferential production or consumption and the lawfulness of mandatory minimum blending or other content requirements. Thus, the debate is still ongoing on whether, and if so how, to clarify or even change WTO rules to tailor them according to the particularities of biofuels. This issue is of core concern for biofuel producers because a global trade regime that offers a stable frame for trading biofuels providing legal certainty enhances international trade in biofuels and can provide new opportunities for exporters from efficient developing countries[4] as demand from developed countries is rising.

Third, as biofuels are an instrument in environmental protection efforts and reduction of greenhouse gases, in particular, as regards their use as environmentally friendly transportation fuels, though contested,[5] the issue of the interaction between WTO law and international environmental protection and climate change instruments which operate outside the WTO framework arises.[6]

Against this backdrop of rather complex issues, this contribution will attempt to give a survey of core WTO issues on trade in biofuels, in particular the compatibility of unilateral measures taken with regard to fostering biofuels trade. Thus, it will contribute to determining the policy space available for WTO members in the field of trade in biofuels. Questions such as the lawfulness of tax measures or the

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[3]The Doha Declaration (para. 31 (iii)) calls for the reduction or elimination of tariff and non-tariff barriers for environmental goods.

[4]The production costs, for example, of ethanol made from wheat in Europe are almost twice as high as those when it is made from sugar cane in India.

[5]The environmental friendliness of biofuels can be assessed critically because of the risks to biological diversity and food supply security and because of poorly sustainable growth of certain feedstocks. It is not self-evident whether biofuels produce more energy than is necessary for their production and whether their greenhouse gas balance really is positive when looking at their complete life cycle. See, inter alia, Echols, Biofuels Certification and the Law of the WTO, ICTSD Agricultural Trade and Sustainable Development, Issue paper 19, August 2009, p. 4. This may change with second-generation biofuels, which are based on non-food plants or plant waste.

[6]See Zarrilli, Biotechnology in the energy sector: some implications for developing countries, in: Wüger/Cottier (eds.), *Genetic Engineering and the World Trade System*, 2008, pp. 151 et seq. (170–172).

usefulness of the Generalized System of Preferences (GSP) scheme to foster biofuels in developing countries will be addressed. A recent example of a contested domestic biofuel regulation is the EU's Renewable Energy Directive.[7] A debate over its compatibility with WTO law has started,[8] and this debate will exemplify the room for manoeuvre available to WTO members regarding mandatory emissions and land-related sustainability criteria.

Biofuels' Tariff Issues

Classification of Biofuels and Its Consequences

The starting point for the application of tariffs under WTO law is the classification of a given good within the member's tariff schedules. The schedules are subdivided according to the Harmonized Commodity Description and Coding System, the so-called HS nomenclature, which forms a unified single basis for the description of goods providing a system of binding six-digit categories under which each good has to be arranged. According to the nomenclature, ethanol and biodiesel have been classified completely differently since 2005. Biodiesel is produced through a chemical process as the oils are extracted from oil crops by chemical means and then processed further. Thus, biodiesel is classified under Chapter 38 of the HS code, which gathers miscellaneous chemical products, under HS code 382490, which applies to products of chemical industries not specified elsewhere. This follows from a decision to alter the Explanatory Notes by the World Customs Organization in 2005 to classify biodiesel under code 382490. Ethanol, in contrast, is made from sugar contained in sugar cane or sugar beet or particular grains. The sugars are converted by biological or chemical means. Since ethanol is an alcohol, it is still attributed to Chapter 22 on beverages, spirits and vinegar, thus classifying agricultural goods. HS code 2207 is applied, which covers undenatured (220710) and denatured (220720) alcohol. Very contested is the classification of biomass fuels. It is not clear whether they should be classified as an industrial or an agricultural good.

The diverse classification of biofuels reflects the current state of play and does actually not make sense since ethanol and biodiesel serve similar ends. The diverse classification could finally be altered by the Doha Round if biofuels are included in the category of *environmental goods*. Some members such as Brazil at least informally proposed considering biofuels in this list in the negotiations in the Committee on Trade and Environment. The Doha mandate insofar does not exclude

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[7]Directive 2009/28/EC on the promotion of the use of energy from renewable sources, OJ 2009 L 140/16.

[8]See, e.g., the critical assessment by Mitchell/Tran, The Consistency of the EU Renewable Energy Directive with the WTO Agreements, Georgetown Law Faculty Working Papers, October 2009.

the consideration of agricultural goods as environmental goods. But other members fear that integrating biofuels into the liberalization of environmental goods might raise the contentious issue of their subsidization.[9] Furthermore, the possibly negative impact on land use and the concerns raised about unsustainable production methods added to the cautious approach because confining liberalization to unsuspicious biofuels required a common agreement on standards and labelling to differentiate the "good" biofuels from the bad ones. The proposal tabled by the USA and the EC in 2007 for a list of 43 environmental goods did not mention biofuels. Therefore, it appears very unlikely that biofuels will be included in the liberalization of environmental goods and services.

A consequence of the different categorization is the applicability of different domestic support schemes. Since ethanol is classified under Chapter 22, it is an agricultural good to which the AoA applies (Article 2 in conjunction with Annex 1 AoA). Thus, Article 4.2 applies to ethanol trade barriers requiring the tariffication of particular quantitative restrictions, and special rules on subsidies apply deviating from the SCM (Article 6 et seq, Article 13 AoA). Such differences in legal regime applicable to biofuels could be changed only if their classification is altered by an amendment to the HS. As the next reform will be implemented from 2012, it is a time-consuming process. Additionally doubts remain as to whether an amendment specifically directed to a uniform biofuel classification is feasible at all given the identity or at least similarity of biofuels to goods produced for non-fuel purposes. If the end use is the *only* criterion to distinguish goods in their tariff classification, the applicability of the specific classification cannot be easily verified by customs officials.[10]

Aligning Tariffs for Biofuels Unilaterally?

The current difference in tariff treatment of biofuels does not seem useful given the similarity of the purposes and end uses of biofuels. This poses the question whether states enjoy policy space to avoid differences in tariff treatment.

WTO members may align the applicable tariff rates on biofuels by differentiating between different uses of the products classified under the HS heading. It is legally possible to unilaterally establish different tariffs within the category of ethanol, for example, as long as they are below the bound tariffs (otherwise they violate Article II GATT) as the HS classification does not prohibit introducing further subclassifications below the six-digit level and as the classification of ethanol is determined according to its chemical composition and not to its end

[9] Sugathan, Enhancing market access for biofuels: What roles for environmental goods negotiations? BioRes 8 (2008) 4, p. 8.

[10] Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 13 points, however, to certain remedies, e.g. by requiring colouring.

use as fuel (in contrast to the classification of biodiesel, which refers also to end use as fuel for diesel engines[11]). In *Spain – Tariff Treatment of Unroasted Coffee*, a GATT panel ruled that a party has the right to introduce in its customs tariff new subpositions.[12] Recently, the Appellate Body held that members can refer also to exogenous factors for a different calculation of tariffs.[13] Thus, WTO members could differentiate between ethanol for fuel use and non-fuel-use ethanol and introduce a lower tariff for fuel-use ethanol only, provided that it is applied irrespective of the origin as demanded by the most-favoured-nation (MFN) treatment obligation under Article I GATT.[14] This implies that non-fuel-use ethanol and fuel-use ethanol are not like products in the sense of Article I GATT otherwise a country importing non-fuel-use ethanol, thus subject to higher tariffs, could claim discrimination against like products. Given the difference in end use, the chemically identical ethanol products are different as the consumer habits and their end uses are decisive in assessing whether goods are like or not.[15] In the *Spain – Tariff Treatment of Unroasted Coffee* case the panel opined that the differences in geographical factors, cultivation methods or the processing of beans are not sufficient reason to justify unlikeness and, accordingly, a difference in tariff treatment of different types of coffee even though taste and aroma would differ.[16] The differences in that case, however, did not relate to different end uses as the unroasted coffee beans were almost exclusively sold in the form of blends combining various types so that the consumer did not differentiate between the different types of beans.[17] This statement allows for a reverse conclusion to the effect that similar goods are unlike if the consumer clearly differentiates because of intended end uses.

Another question then would be whether the reduced tariff could be confined to specific biofuels by, e.g., excluding fuel-use ethanol that had been produced in a non-sustainable way. This touches upon two questions under Article I GATT: first, the issue as to whether this was a condition prohibited under Article I GATT ("shall be accorded *immediately and unconditionally*"), as the same treatment has to be applied unconditionally, and second, as to whether products are like in spite of such differences ("…to the *like* product"). As regards the first question, the interpretation of "unconditional" is contested.[18] Whereas some panel reports appear to highlight that "unconditional" literally means that the same treatment has to be

[11]See Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 11.

[12]BISD 28S/102, para. 4.4.

[13]See Appellate Body, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, paras. 273 et seq.

[14]See Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, pp. 10, 13.

[15]van den Bossche, *The Law and Policy of the WTO*, (2nd ed.) 2008, p. 330.

[16]Loc.cit (fn. 11), para. 4.5–6

[17]See para 4.7.

[18]See van den Bossche, *The Law and Policy of the WTO*, (2nd ed.) 2008, p. 334, who calls for future clarification by the Appellate Body.

applied without further differentiation or additional prerequisite, i.e. "not limited by or subject to any conditions"[19] (except in case the goods are unlike), others appear to propose that "unconditional" must be considered in the context of examining whether the measure involves discrimination between like products. The latter approach means that legitimate differentiation is acceptable, and thus a condition may be imposed for receipt of a preference as long as all WTO members are eligible to satisfy the condition, which must be related to the product and not to its origin.[20]

The second question as to whether products can be held unlike merely because of their different production methods without any reflection in the physical/chemical characteristics of the produce itself is an issue similar to that of differentiating products by introducing domestic regulation which refers to sustainability standards and requires certain properties of the production methods. The so-called process and production method (PPM) debate is addressed later. *Howse* thinks that origin-neutral environmental criteria which are supported by international environmental treaties may not discriminate.[21] One might object that there might be a de facto discrimination if the differentiation places imports of a specific member at a disadvantage.[22] The only remedy then remaining is to justify the discrimination under Article XX GATT. This will be dealt with below.

Tariff Preferences and Biofuels

Beneficial tariff treatment of particular biofuel exporters is possible under preferential trade agreements according to Article XXIV GATT by entering into a free trade agreement or by establishing a free customs area. Furthermore, the former waiver for the EU legalized a deviation from MFN treatment for biofuel exporters. The EU had provided a duty-free treatment of biofuel imports in its last agreement with African, Caribbean and Pacific states.[23]

A more general scheme for providing preferential tariffs is the GSP, which can also be used to favour biofuel exports. The so-called Enabling Clause[24] allows

[19]Panel, *EC – Conditions for the Granting of Tariff Preferences to Developing Countries (EC-GSP)*, WT/DS246/R, para. 7.59.

[20]See Panel, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, paras. 14.145–147 and Panel, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS42/R, para. 10.23, though both panels have slightly divergent views.

[21]Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 14.

[22]Regarding the discriminatory effect/group approach see Lester/Mercurio, World Trade Law, 2008, pp. 275 et seq.

[23]Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 14.

[24]Decision of 28 November 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries.

developed states to accord preferential tariff treatment to products originating in developing countries in accordance with the GSP by providing generalized, non-reciprocal and non-discriminatory preferences (see paragraph 2 lit. a). Thus, the WTO members can grant particular benefits to biofuel exports from developing countries.

Another question is whether the industrialized members could confine tariff benefits to biofuels which meet certain criteria, for example, to safeguard sustainable production. The EC GSP case on the EU GSP's Drug Arrangement which had introduced additional benefits for 12 developing countries that performed well in the combat against drug production and trafficking brought some clarity that GSP preferences may not necessarily apply to every developing country but can be constrained to some developing countries that fulfil additional criteria as long as those criteria are non-discriminatory in the sense that basically they can be met by every developing country. Thus, positive conditionality is possible under the GSP,[25] and the non-discrimination requirement under the Enabling Clause is not a formal one,[26] but a material one which allows for differentiation within the group of developing countries according to their differences because the Enabling Clause provided for differential treatment "to respond positively to the development, financial and trade needs" (see paragraph 3 lit. c). Since these needs are not necessarily shared to the same extent, a GSP scheme may be non-discriminatory even if formally identical treatment is not accorded to all beneficiaries. According to the Appellate Body, preference-granting WTO members "are required, by virtue of the term" non-discriminatory "to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is to all that have the development, financial and trade needs to which the treatment in question is intended to respond".[27] The Appellate Body required identical treatment to be available to all similarly situated beneficiaries, i.e. to all developing countries that have the needs to which the treatment is intended to respond. In consequence, WTO members in their GSPs may differentiate among developing countries if they have just cause to do so provided the criteria are objective and transparent, allow all developing countries to be included once they satisfy the criteria and there is a sufficient nexus between the need identified and the additional incentives.[28] The question is whether different production standards for biofuels are a just cause for differentiation. It appears to be ruled out that conditions which are unrelated to a country's development, financial or trade needs are permissible because the Enabling Clause

[25]See Bartels, The WTO Enabling Clause and Positive Conditionality in the EC's GSP Program, JIEL 6 (2003), p. 507; Switzer, Environmental Protection and the generalized system of preferences: A legal and appropriate linkage? ICLQ 57 (2008), p. 113.

[26]Which was the approach adopted by the WTO Panel in WT/DS246/R, para. 7.161 according to which identical preferences to all developing countries without differentiation were required. The Appellate Body reversed this in *EC-GSP*, WT/DS246/AB/R, para. 174.

[27]Appellate Body, *EC-GSP*, WT/DS246/AB/R, para. 173.

[28]For more detail see Switzer, Environmental Protection and the generalized system of preferences: A legal and appropriate linkage? ICLQ 57 (2008), pp. 113 et seq. (132).

has to be designed to respond positively to the development, financial and trade needs of developing countries. Hence, the Appellate Body opined that the types of needs to be addressed are limited to development, financial and trade needs.[29] Thus, WTO members are requested to show in an objective way that the purposeful promotion of sustainable production methods for biofuels fosters the development of the beneficiaries and has to do with their development needs. Insofar, one might point to the indisputable insight that developing countries should favour sustainable development concepts over non-sustainable ones in the interest of their long-term development, and that these concerns are recognized under international instruments such as the Biodiversity Convention and the Kyoto Protocol.[30] This appears, however, not to be beyond any doubt if the benefits are available for biofuels only and not with regard to other products as well. Sustainable development means more than focussing on sustainable production of biofuels.[31] This critic is related to the much broader issue of who is to decide about the conditions for benefits. To avoid donors singling out very specific conditions which are in their favour, one might restrain them to pursue global values by incentives.[32] Such demands, however, have not yet been placed by the WTO jurisprudence.

Market Access of Biofuels

Besides tariffs there are other impediments to cross-border trade in goods, so-called non-tariff barriers to trade. They encompass quantitative and qualitative restrictions on market access. Such restrictions are first of all addressed by WTO non-discrimination disciplines which oblige WTO members not to discriminate against foreign goods. They are enshrined in Article I GATT (the already mentioned MFN clause which applies beyond tariffs also to any rule or formality in connection with importation or exportation and to domestic regulation) and Article III GATT on national treatment. Although Articles I, III GATT only provide for equal treatment and thus usually do not cover non-discriminatory domestic rules, Article XI GATT prohibits quantitative restrictions and “other measures”. As a consequence of these

[29]Appellate Body, *EG-GSP*, WT/DS/246/AB/R, para. 163.

[30]Thus, an incentive for sustainable biofuel producing developing countries made dependent on the conformity with these instruments is regarded as lawful under the GSP, Switzer, International Trade Law and the Environment: Designing A Legal Framework To Curtail the Import of Unsustainably Produced Biofuels, Journal of International Trade Law and Policy 8 (2007), pp. 30 et seq. (42–43).

[31]See Brühwiler/Hauser, Biofuels and WTO disciplines, Aussenwirtschaft 63 (2008), pp. 7 et seq. (21).

[32]See Apea/Shaffer, Institutional Choice in the GSP case: Who decides the Conditions for Trade Preferences? J.W.T. 39 (2005), pp. 977 et seq. (997–999); Switzer, Environmental Protection and the generalized system of preferences: A legal and appropriate linkage? ICLQ 57 (2008), pp. 113 et seeq. (140–145).

disciplines, national internal regulations on goods basically are subject merely to non-discrimination obligations and not to more-far-reaching disciplines as regards substantive requirements. In particular, there are no general WTO disciplines on goods as regards the question as to whether internal regulations are not more burdensome to global trade than necessary to achieve the legitimate domestic policy objective, except the TBT and the SPS agreements. The latter two agreements prescribe further leading requirements as they oblige the WTO members to consider or even adapt to international standards in their domestic regulations on the production of goods; they also oblige domestic regulation not to be more burdensome than necessary, which in case of the SPS agreement even has to be established by scientific risk assessment.

Biofuels pose intricate questions as regards these disciplines and these shall be analysed here in more detail. First, the non-discrimination obligation in Article III GATT shall be considered: this applies to fiscal as well as non-fiscal domestic regulation, and the general exception to GATT disciplines enshrined in Article XX GATT which might become relevant in the area of biofuels as well because it justifies requirements for environmental reasons (see Article XX lit. (b) and (g)) GATT. Then, the TBT and the SPS agreements will be looked at.

Biofuels and Most-Favoured-Nation Treatment, Article I GATT

Article I GATT does not only apply to tariffs but also to other charges or other regulations which stipulate non-fiscal requirements (domestic requirements addressed in Article III GATT are explicitly mentioned). Thus, Article I GATT is also relevant for such requirements with regard to biofuels. Any domestic regulation which grants an advantage or privilege, such as a reduced tax burden or a beneficial regulatory treatment, to any imported good must accord unconditionally the same treatment to any other imported like good from a WTO member. In essence Article I is a non-discrimination obligation which prohibits differentiation among foreign trading partners.

Assessing the conformity of national trade rules with Article I GATT requires, similarly as in Article III GATT, a statement of likeness of goods and a comparison of the treatment accorded. Whereas Article III:4 GATT requires a not less favourable treatment, Article I:1 GATT obliges members to accord the same advantage or benefit immediately and unconditionally. Interestingly, the interpretation of "unconditional" conforms more and more to the evaluation of the no less favourable treatment standard in Article III:4 GATT; at least it develops in a comparable way as under both articles the relevant issue becomes whether there are inherent reasons for acceptable conditionality. With regard to both articles, the jurisprudence progressed to the question whether like goods can be treated differently as long as any difference in treatment is origin-neutral also in its effect and relates to product characteristics. Suffice it to challenge the reader to compare the interpretational problems developments of "unconditional" referred to above (B. II) and those

regarding the "not . . . less favourable" treatment in Article III GATT introduced later. Besides, it would be futile to adopt standards which are further-reaching under Article I GATT than under Article III GATT with regard to domestic regulation covered in Article III:4 GATT. It was not acceptable to develop the equal treatment of foreign goods in a more elaborate and sophisticated way than their equal treatment with domestic products. For this reason, the analysis of Article I GATT shall not be deepened here. What has already been said (see B. II) may suffice. Instead, our analysis of the relevance of WTO law for biofuels immediately turns to Article III GATT.

Biofuels and National Treatment, Article III GATT

Equal Fiscal Treatment, Article III:2 GATT

The Disciplines of Article III:1 and Article III:2 GATT and the Issue of Likeness

Article III:2 GATT in its first sentence provides for equal internal goods taxes and other charges[33] for domestic goods and like foreign goods of any WTO member. Article III:2 sentence 2 GATT, read in conjunction with Article III:1 GATT requires directly competitive and substitutable goods to be taxed in a way that does not afford protection to domestic production. Thus, in the interpretation given to Article III:1 and Article III:2 GATT by panels and the Appellate Body, there are two slightly different standards of equal treatment.[34] Whereas like products have to be charged not in excess of the taxes and charges applicable to like domestic goods, products which are merely directly competitive and substitutable may face little, non-substantial differences[35] in taxation as long as the differences are not so great as to be protective to domestic products (see Article III:2 sentence 2 GATT). Establishing a protective effect of non-substantial tax differences requires a comprehensive and objective analysis of the structure and application of the measure (e. g. by an analysis of the effects of a combination of high tariffs and differentiated internal taxes). In this assessment, regulatory intentions and trade effects may come into play.

Regarding biofuels this means in essence that the likeness of products becomes the yardstick of strict equal tax treatment. And if biofuels are not like goods but still competitive or substitutable (which then is the looser standard), foreign biofuels can be treated worse to a limited extent.

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[33]Article III:2 GATT only applies to internal taxes on goods/products, and not to income taxes or import duties. Income taxes might however be relevant under Article III:4 GATT as this paragraph applies to domestic regulations in a broad sense, see van den Bossche, *The Law and Policy of the WTO*, (2nd ed.) 2008, pp. 349 et seq., fn. 116.

[34]See van den Bossche, *The Law and Policy of the WTO*, (2nd ed.) 2008, pp. 349 et seq. (359).

[35]Substantial tax differences are protective and violate Article III:2 GATT.

As concerns the concept of likeness under Article III:2 GATT and WTO jurisprudence compares – following the Border Tax Adjustments Report of a GATT working party[36] – the properties of goods, their end uses and consumers' tastes and habits, and a limited value also has to be ascribed to different tariff classification.[37] Ethanol and biofuel, for example, are not like goods though both are biofuels. But their end uses and physical product characteristics are different, as is their tariff categorization. Thus, ethanol and biodiesel can be taxed differently.

The next question to be answered is whether those fuels are directly competitive or substitutable, which relates to a "broader category" of products than the likeness in Article III:2 sentence 1 GATT, which requires interchangeability looking at competition in the relevant markets as one means.[38] This is the case if they show some kind of cross-elasticity. An increase in price of biodiesel, however, does not cause a shift in demand for ethanol as they cannot be exchanged. Engines use either biodiesel or ethanol.

Therefore, since biodiesel and ethanol are completely different goods, the national treatment requirement as regards internal taxation and other charges does not apply. Both biofuels can be treated completely diversely. Within each category of biofuel, the national treatment obligation under Article III:2 GATT applies, so imported ethanol must not be taxed in excess of the tax applicable to domestic ethanol. A tax rebate or tax reduction which depends on the use of domestically sourced ethanol or on local content requirements violates Article III:2 GATT.

Likeness and Process or Production Method Requirements

The aforementioned national treatment requirements, however, apply only as long as the product characteristics of imported and domestic ethanol are equal. This touches the issue of possible differentiations with regard to particular characteristics. In other words: Do the WTO members have the discretion to introduce different taxes for ethanol depending on the *production method*, for example? Are the products still alike if one ethanol product is produced in an environmentally friendly and sustainable way whereas the other ethanol product is not? Other *standards* could refer to the environmental impact solely in the country of import or could refer – more demandingly – to the impact of the biofuel on the reduction of

[36]Adopted 2 December 1979, L/3464.

[37]See Appellate Body, *EC – Measures Affecting Asbestos and Asbestos Containing Products (EC – Asbestos)*, WT/DS135/AB/R, para. 133; though the jurisprudence on likeness is contested, this contribution builds on it. For a completely different, more economic approach on likeness see Choi, *"Like Products" in International Trade Law*, 2003.

[38]Appellate Body, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 25; Appellate Body, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/AB/R, p. 25.

carbon emissions globally by looking at the net effects throughout the entire life cycle of the biofuel and the feedstock inputs.[39]

The assessment very much depends on the particulars of the domestic regulation of the country of import. If a difference in treatment can be established to depend on *different physical or chemical characteristics* of a biofuel, e.g. by showing that some biodiesel can be burnt in a cleaner way with a lower level of emissions than others, this difference in treatment refers to different characteristics and may meet different consumer preferences, thus resulting in non-likeness of the two types of biodiesel. Unlike products may be taxed differently. The question then remains whether the two types nevertheless are directly substitutable and competitive. If so, the difference in taxation must not be considerable and must not favour domestic goods in a way that protects them. Two types of biodiesel, for example, one of which is more environmentally friendly in its characteristics than the other, can be seen as directly substitutable and competitive because they serve the same end uses, meet the same purpose and clearly might show some cross-price elasticity as an increase in price of the more environmental friendly biodiesel may shift the demand to the other less environmentally friendly (but still more friendly than fossil fuel) diesel. Then WTO law only allows for a not substantial difference in tax treatment subject to establishing that the difference does not protect domestic biodiesel, for example by showing that also a considerable share of domestically produced biodiesel is subject to the higher tax.

If the biofuels do not have different physical or chemical characteristics because the standards required by domestic taxation regulation refer to *process and production requirements* which have no influence on the physical characteristics of the good (for example by stipulating land-related sustainability criteria according to which biofuels must not have been made from raw materials obtained from land with high biodiversity value or with high carbon stock capacity), the question arises whether consumer choices and preferences related merely to the process or production methods and their environmental impacts suffice for treating goods that share the same end uses as unlike products. The Appellate Body report in the *EC – Asbestos* case does not provide clear guidance insofar because in the *EC – Asbestos* case[40] the two products were different in their physical characteristics as one contained asbestos fibres and the other did not, and this difference resulted in different health impact.[41] In the first Tuna Dolphin GATT panel ruling, differences in the process or production methods were not perceived as related to the product itself; this assessment, however was taken with regard to the Ad note to Article III

[39]See Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 25.

[40]Appellate Body, *EC – Measures Affecting Asbestos and Asbestos Containing Products (EC – Asbestos)*, WT/DS135/AB/R, para. 128.

[41]See also van Dam et al., Overview of recent developments in sustainable biomass certification, Biomass and Bioenergy 2008, pp. 749 et seq. (765).

GATT and the issue of delineating the scope of application of Article III and Article XI GATT and *not* with regard to likeness under Article III GATT.[42]

If one considers this issue under the aim of Article III GATT to ban protectionist differentiations (see again Article III:1 GATT) and to allow for legitimate policy objectives to be pursued, one might conclude that given the fact that environmental and sustainability issues are relevant today, and without doubt basically form legitimate policy objectives, in particular taking into account consumer preferences and habits, such differences may lead to an evaluation of the products concerned as unlike. One objection one might raise is whether Article III GATT and the likeness criterion is the right place to distinguish acceptable from discriminatory practices. Maybe the examination of justifications (Article XX GATT) would be a better place since Article XX GATT allows for more nuanced views regarding necessity, whereas under Article III:2 GATT (and even more under Article III:4 GATT) the likeness issue is crucial for the scope of application of WTO disciplines: If products are held to be unlike, the non-discrimination obligation does not apply (at least under Article III:4 GATT) or only to a lesser extent (under Article III:2 sentence 2 GATT). Furthermore, with regard to Article III:2 GATT one has to bear in mind that even though two products may be held to be unlike, they still very likely might come under the scrutiny of Article III:2 sentence 2 GATT because the difference in consumer perceptions might be dependent also on prices. Products that share the same end use but differ in environmental aspects usually will be seen as interchangeable and mutually competitive, so the disciplines of Article III:2 GATT apply to the effect that differences in tax treatment must not be so great so as to afford protection to domestic production.

This issue of acceptable differentiation with regard to PPMs is even more important under Article III:4 GATT because the likeness issue then decides about the application or non-application of WTO–national treatment obligations. Therefore, this will be looked at more closely now dealing with Article III:4 GATT.

Non-Fiscal Equal Treatment: Article III:4 GATT

Article III:4 GATT obliges WTO members to treat foreign products not less favourably than like domestic products with regard to domestic non-fiscal requirements (“all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use”). Thus a broad range of domestic requirements made operational through sustainability or certification schemes falls under the purview of Article III:4 GATT, for example mandatory requirements to use biofuels, blending requirements, requirements as regards the product characteristics or the life-cycle environmental performance or the labelling

[42]See Panel, *US – Restrictions on Imports of Tuna*, DS21/R, para. 5.9–5.19.

or certification of biofuels or biomass. In particular, the relevance of labelling and certification schemes[43] for environmental protection is subject to debate all the more since they have been addressed by the Doha Ministerial, which instructed the Committee on Trade and Environment to give particular attention to labelling requirements for environmental purposes.[44] The Committee on Trade and Environment in its later report did not see any particular need for more specific disciplines insofar.[45] Another problem of sustainability certification schemes is their resource-demanding nature, so small producers could be locked out and the market could be dominated by large-scale producers[46] – a concern for developing countries that discovered biofuels as a means for rural development.[47] Still another issue is the lawfulness of certification schemes which operate not for environmental but for social reasons such as the one in Brazil. Brazil grants benefits to biodiesel producers if they purchase their feedstock from small farmers and run a specific assistance programme.

Likeness

The first step in assessing whether a domestic requirement conforms to Article III:4 GATT is, again, the issue of likeness, which is to be understood similarly to the concept of directly competitive and substitutable goods as under Article III:2 GATT. The notion of "like" in Article III:4 GATT encompasses more than "like" under Article III:2 GATT, but is not necessarily coextensive with the combined scope of likeness and the direct competitiveness and substitutability in Article III:2 GATT.[48] At least the products must be in a competitive relationship to be like products in the sense of Article III:4 GATT. In examining likeness factors which are probative of a competitive relationship between domestic and imported goods such as the properties, end uses and consumer tastes have to be considered.[49] The Appellate Body denied the aims and effects test, which required consideration of whether the distinction is based on non-protectionist intents.[50]

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[43]For an overview of recent developments see van Dam et al., Overview of recent developments in sustainable biomass certification, Biomass and Bioenergy 2008, p. 749.

[44]Doha Ministerial Declaration, para. 32.

[45]See the report to the fifth session of the WTO Ministerial Conference in Cancún, WT/CTE/8 para. 37.

[46]See Zah et al. Standardized and simplified life-cycle assessment (LCA) as a driver for more sustainable biofuels, Journal of Cleaner Production 17 (2009) Supplement 1, p. S102.

[47]Echols, Biofuels Certification and the Law of the WTO, ICTSD Agricultural Trade and Sustainable Development, Issue paper 19, August 2009, p. 1.

[48]See also Choi, *"Like Products" in International Trade Law*, 2003, pp. 111–112.

[49]Appellate Body, *EC – Measures Affecting Asbestos and Asbestos Containing Products (EC – Asbestos)*, WT/DS135/AB/R, para. 117.

[50]See Howse/Türk, The WTO impact on Internal Regulations – A case study of the Canada-EC Asbestos Dispute, in: Burca/Scott (eds.), *The EU and the WTO*, 2001, pp. 283 et seq. (287).

As already pointed out, the Appellate Body in the *EC – Asbestos* case placed a very heavy burden on the complainant to show that despite physical differences in products they still are in a competitive relationship, so that all of the evidence demonstrates that the products are like.[51] The Appellate Body thus favours an inference to be drawn from a difference in physical characteristics to the effect that the products compared are distinct.[52] This means that a difference in physical characteristics, in particular if it affects the health or the environmental impact of the good, usually allows for assessing two goods as being unlike. As a consequence, WTO members can treat the unlike goods, e.g. biodiesels, with different physical characteristics differently. Article III:4 GATT cannot be violated as the goods to be compared are unlike.

The *EC – Asbestos* report does not directly address the issue as to whether two goods though physically identical could be seen as unlike.

Some object the idea that products which share the same end-uses, characteristics and properties and which are more or less physically identical could be regarded as unlike. The core argument is that allowing states to differentiate between physically similar products amounts to an extension of regulatory powers and blurs the territorial division of regulatory powers: If a distinction based on PPMs were acceptable, a regulating WTO member could regulate on production processes which occur in the exporting WTO member, whose policies are not under the jurisdiction of the importing WTO member.[53] According to these voices, physical characteristics of products can be regulated by the importing member but not non-product-related policies.[54] Such arguments, however, are not convincing in their generality. First, consumer preferences may depend even on non-physical properties of products which still may be product-related.[55] Second, the reference to a territorial division of regulatory autonomies is besides the point in the case of global problems such as greenhouse gas emissions and air pollution, which by their nature cannot be contained within domestic borders. Thus, regulatory requirements of the importing WTO member that link benefits to low carbon emissions over the whole life cycle or that make benefits dependent on other

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[51]Appellate Body, *EC – Measures Affecting Asbestos and Asbestos Containing Products (EC – Asbestos)*, WT/DS135/AB/R, para. 118, 136.

[52]Appellate Body, *EC – Measures Affecting Asbestos and Asbestos Containing Products (EC – Asbestos)*, WT/DS135/AB/R, para. 121.

[53]Marceau/Trachtman, A Map of the World Trade Organization Law of Domestic Regulation of Goods, in: Berman/Mavroidis (eds.), *Trade and Human Health and Safety*, 2006, pp. 9 et seq. (55 et seq.).

[54]Marceau/Trachtman, A Map of the World Trade Organization Law of Domestic Regulation of Goods, in: Berman/Mavroidis (eds.), *Trade and Human Health and Safety*, 2006, p. 56.

[55]See also Marceau/Trachtman, A Map of the World Trade Organization Law of Domestic Regulation of Goods, in: Berman/Mavroidis (eds.), *Trade and Human Health and Safety*, 2006, p. 56 fn. 194.

contributions to combating climate change or to biodiversity gains refer to global commons for which a respect for the territorial jurisdiction of the exporting WTO member is useless and futile. Admittedly, there may be other regulatory requirements by which the actions of an importing member may impact on the sustainability of the production method or even on labour, human rights and other social conditions related to the production process in the exporting WTO member state which have no bearing on universal climate change, for example if the life-cycle assessment has to include also indirect emissions by land-use change (except if this is related to the conservation of rainforests, whose eminent importance for the global climate has been established). But even then one should not from the outset reject the possibility of goods being held distinct simply because they differ in aspects which were or could have been also subject to regulations in the exporting WTO member state.

What appears to be more decisive then is that the effects of the different PPMs may be considered in defining whether two goods are like or not. There is neither a general assumption in favour nor a general assumption against unlikeness if two goods merely differ in the PPMs (without any impact on their physical characteristics). Each case has to be looked at individually. If the process and production differences have an impact on consumer preferences but not to an extent that the consumers may always favour one over the other (in particular if the environmentally (more) friendly product is much more expensive) the cross-price elasticity of the two goods may easily be established, so the two goods are in a competitive relationship and might be held like.[56] Additionally, the more remote the distinguishing criteria are from features consumers attribute to a particular product, the more probably panels/the Appellate Body will state likeness,[57] in particular in the case of production requirements referring to human rights and social standards. In sum, although one can agree with the view that the Appellate Body's application of the likeness test as a competition-based test in *EC – Asbestos* suggests that in most cases different PPMs might prove insufficient to make products unlike,[58] there are differentiations which may make products be distinct, in particular if consumers can associate the distinctive feature with a product.[59] And even if the products are like products, this does not mean – as Marceau and Trachtman assume – that Article III GATT then "prohibits treating like products differently

[56]See also Zarrilli/Burnett, Certifying biofuels: benefits for the environment, development and trade?, in Cottier/Nartova/Bigdeli (eds.), *International Trade Regulation and the Mitigation of Climate Change*, 2009, pp. 197 et seq. (217).

[57]Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 27.

[58]Marceau/Trachtman, A Map of the World Trade Organization Law of Domestic Regulation of Goods, in: Berman/Mavroidis (eds.), *Trade and Human Health and Safety*, 2006, p. 57.

[59]See Brühwiler/Hauser, Biofuels and WTO disciplines, Aussenwirtschaft 63 (2008), pp. 7 et seq. (26 et seq.).

on the basis of PPM considerations"[60] because not every difference in treatment amounts to a less favourable treatment. This issue will be looked at more closely now.

Non-Less-Favourable Treatment

The second step in assessing whether a domestic requirement conforms to Article III:4 GATT is the equal treatment test. In the words of Article III:4 GATT, products from abroad must not be treated less favourably than like domestic products. Though the wording relates to products, it also applies to producers. If any benefit is related, e.g. to the size of the producer or a specific characteristic of the producer, and the benefit is not granted to other producers of an imported like good, Article III:4 GATT is violated.[61]

The wording of Article III:4 GATT is noteworthy since it does not prescribe for an equal treatment in every respect. In the *EC – Asbestos* case, the Appellate Body in an obiter dictum allowed a member to draw distinctions between like products without for this reason alone according a less favourable treatment.[62] Thus, differences in treatment of like domestic and imported goods do not necessarily amount to a violation of Article III:4 GATT. The statement of the Appellate Body was interpreted to allow for a regulatory distinction as regards PPM requirements as long as these requirements apply equally to imported and domestic like products[63] (which is another intricate question dealt with later[64]). Thus, even if two types of ethanol which had been produced in different ways, one of which is more environmentally friendly or more sustainable than the other, are considered to be like products, they still could be treated differently insofar as the difference in treatment refers to their different production methods. Such interpretation of the non-less-favourable treatment requirement contained in Article III:4 GATT is backed by a material understanding of the concept of non-discrimination. Non-discrimination does not prohibit any difference in treatment but only a difference in treatment which has no objective, legitimate reason or whose extent is in an inappropriate

[60]See again Marceau/Trachtman, A Map of the World Trade Organization Law of Domestic Regulation of Goods, in: Berman/Mavroidis (eds.), *Trade and Human Health and Safety*, 2006, p. 57.

[61]See Echols, Biofuels Certification and the Law of the WTO, ICTSD Agricultural Trade and Sustainable Development, Issue paper 19, August 2009, p. 13.

[62]WT/DS135/AB/R, para. 100 – EC – Asbestos.

[63]R. Howse/E. Türk, The WTO impact on Internal Regulations – A Case Study of the Canada-EC Asbestos Dispute, in Burca/Scott (eds.), The EU and the WTO, 2001, 283 at 289.

[64]A formal difference in treatment is neither necessary nor sufficient to show a violation of Article III:4, and a measure even though equally applicable to importers and domestic producers might in certain circumstances nevertheless amount to a less favourable treatment, see Appellate Body, WT/DS161/AB/R, WT/DS169/AB/R, para. 137 – Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef, and Appellate Body, WT/DS 302/AB/R, para. 94 – Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes.

relation to the existing differences. Again one could refer to Article III:1 GATT and the general principle enshrined there, which informs the intention also of Article III:4 GATT, i.e. to avoid giving protection to domestic production. This link was explicitly drawn by the Appellate Body in the *EC – Asbestos* case[65] and conforms to a contextual interpretation of Article III:4 GATT.[66] And there are other indications in the body of WTO case law which testify to a material notion of non-discrimination. The Appellate Body in *Dominican Republic – Cigarettes* stated that the existence of a detrimental effect on imports does not necessarily imply a less favourable treatment if the detrimental effect is explained by factors unrelated to the foreign origin of the product.[67] The panel in the *EC – GMO* case required the complainant to allege that the treatment of products differed depending on their origin. An alleged less favourable treatment must be explained by the foreign origin rather than by a difference in the safety of the domestic and imported like products.[68] The mere fact that there was a difference in treatment between imported biotech products and domestic like non-biotech products did not amount to a difference in treatment in violation of Article III:4 GATT as this could be explained by different safety features. It was annotated that this panel report shifts the emphasis of the analysis of Article III:4 GATT from "likeness" to "less favourable treatment", which partially deprives the former of its relevance, and could allow for a different set of rules for certified and non-certified biofuels, in conformity with WTO law.[69]

The interpretation of the meaning of less favourable treatment actually refers to the question whether there is an effective equality of competitive conditions. Thus, even a formal equal treatment of domestic and foreign goods may result in a less favourable treatment if the competitive conditions of imports are worsened.[70] Therefore, a general ban of all advertising treats imports less favourably because it creates unequal competitive opportunities for new foreign suppliers compared with existing domestic suppliers of like goods.[71]

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[65]Appellate Body, *EC – Measures Affecting Asbestos and Asbestos Containing Products (EC – Asbestos)*, WT/DS135/AB/R, para. 100.

[66]Mavroidis, *Trade in Goods*, 2007, p. 252.

[67]Appellate Body, *Dominican Republic – Cigarettes*, WT/DS302/AB/R, para. 96.

[68]Panel, *EC – Measures Affecting the Approval and Marketing of Biotech Products (EC – GMO)*, WT/DS291/R, WT/DS292/R, WT/DS293/R, para. 7.2514.

[69]Zarrilli/Burnett, Certifying biofuels: benefits for the environment, development and trade?, in: Cottier/Nartova/Bigdeli (eds.), *International Trade Regulation and the Mitigation of Climate Change*, 2009, pp. 197 et seq. (219).

[70]See Appellate Body, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS 302/AB/R, para. 94.

[71]See Panel, *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, DS 10/R, para. 78.

Summary: What Does That Mean for the EU Renewable Energy Directive?

In sum, it can be concluded that WTO members enjoy considerable discretion in tailoring their policy to foster biofuels and to differentiate between different types of biofuels as long as this is not related to their foreign origin but is related to objectively verifiable differences in product characteristics or environmental impact. This might be relevant in the assessment of the WTO conformity of the new EU Renewable Energy Directive,[72] whose Article 17 stipulates two sustainability requirements for biofuels to be considered by the EU member states in the calculation of compliance with their renewable energy obligations: The first requirement related to the emissions (Article 17 (2)) requires the biofuels to reduce greenhouse gas emissions at least by 35% by 2016; the second one related to the land used for feedstock cultivation (Article 17 (3)–(5)) requires biofuel to be produced from feedstock obtained from land that did not have a high biodiversity value or a high carbon stock capacity. Thus, the directive differentiates between different types of biofuels solely by reference to their carbon emissions and land use. The first question is whether this differentiation cannot be challenged under Article III GATT because of a lack of likeness. As the emissions-related criterion refers to different product characteristics directly related to the public policy aim of reducing carbon emissions, biofuels that do not meet those standards could be seen unlike.[73] From the consumers' perspective, however, the less environmentally friendly biofuels serve the same end uses. The consumers' preferences may depend merely on prices and not on these characteristics. Thus, the less environmentally friendly biofuel has to be seen as like those biofuels that meet the criteria of Article 17 (2) of the EU directive. The same applies to the land-related sustainability criterion that refers to the land use all the more as it has no impact on product characteristics. As the EU directive requires biofuels to fulfil both criteria cumulatively, these biofuels have to be considered like those that do not meet them.

The evaluation of the EU directive's conformity with WTO law then depends on the interpretation of the less favourable treatment standard. The question then is whether the differentiation discriminates against less sustainable biofuels. On their face, the requirements of the directive operate indistinctly, irrespective of the origin of the biofuels. Also biofuels produced within the EU which do not fulfil Article 17's stipulations cannot be considered in measuring the renewable energy obligations. But those domestic biofuels that fulfil them are favoured over those imported ones that do not fulfil them. Such difference, however, does not amount to less favourable treatment because it is rooted in their different emissions and more sustainable production. A more intricate issue is that of de facto discrimination because the WTO jurisprudence requires such differentiations not to be related to

[72]Directive 2009/28/EC on the promotion of the use of energy from renewable sources, OJ 2009 L 140/16.

[73]See Mitchell/Tran, The Consistency of the EU Renewable Energy Directive with the WTO Agreements, Georgetown Law Faculty Working Papers, October 2009, paras. 6, 16.

the origin of the products. The second, land-related criterion, however, refers to the land used for cultivation of the feedstock. Thus, it refers to the origin of the product. Therefore, it was contended that if it proves that those biofuels not meeting the criteria are typically from certain countries (because tropical countries typically produce biofuels by using high carbon stock land or land of high biodiversity value), the EU directive would treat certain imports less favourably, in violation of Article III GATT.[74] Although this argumentation has its merits, one must not overlook that the land-related requirements are formulated in an origin-neutral way. The fact that most high carbon stock land and most land with high biodiversity value is situated outside the EU, in particular in countries with a high interest in exporting biofuels, cannot save them from regulatory measures motivated by objective sustainability and biodiversity interests. In essence, to conserve such land is an objective that cannot be addressed in an origin-neutral way. Applying Appellate Body parlance in the *Dominican Republic – Cigarettes* case by analogy, one can explain the detrimental effect by factors unrelated to the foreign origin of the product but related to the objective fact that that land most worthy of conservation on a worldwide scale lies in tropical regions. This is a given that cannot be changed and is the starting point for any sustainable climate policy.

Biofuels and Exceptions Under Articles XX and XXI GATT

The need to justify a regulatory measure occurs if the approaches proposed above regarding the interpretation of likeness and the meaning of less favourable treatment are not shared, or if the regulatory measures of the importing WTO member specifically affect imported goods in a negative way. This can be the case if regulatory requirements explicitly favour domestic biofuels or feedstock over imported ones (de jure discrimination) or are not equally applicable or affect domestic and imported goods (de facto discrimination). This may occur even if differences between imported and domestic goods are objectively verifiable. The latter can amount to a less favourable treatment of imported goods if regulatory requirements in fact do not meet domestic production but only address imported goods owing to the latter's particular characteristics which are made the subject of an origin-neutral legislation. An example for this is a WTO member that prescribes a minimum percentage of biofuels in fuel blends and which also prescribes the use of biofuels made from particular feedstock for meeting the blending requirement. Although it appears such a requirement is origin-neutral, it may place imported biofuels at a disadvantage if they typically are made from other feedstocks whereas

[74]Mitchell/Tran, The Consistency of the EU Renewable Energy Directive with the WTO Agreements, Georgetown Law Faculty Working Papers, October 2009, para. 23. In para. 18 essentially the same argument is made with regard to Article I GATT and the required unconditional accord of any advantage.

domestic biofuels are made exclusively from the favoured feedstock as only this is grown in the regulating WTO member state.

Another reason for the relevance of Article XX GATT for the justification of market access restrictions is the relationship between Article III and Article XI GATT. Some GATT panel reports present the view that only internal regulations and requirements which apply to the product fall under the scope of Article III:4 GATT, whereas requirements which have no impact on the physical or chemical characteristics or the contents of the product, in particular certain PPM requirements, come under the purview of Article XI GATT.[75] This approach has considerable consequences. First, Article XI GATT does not merely require equal treatment but prohibits any market access restrictions or prohibitions. Second, and consequently, there is no likeness requirement. Third, Article XI is more comprehensive in scope as it applies also to measures and not only to regulations.[76] Thus, Article XI is a sharp sword as it gives WTO members room for manoeuvre only insofar as their regulations can be justified under Article XX. For this reason, the scope of Article XI should be interpreted narrowly.[77] Additionally, the correctness of the interpretational approach of the GATT panel reports is contested all the more as they are unadopted reports.[78] Irrespective of such contentions, there are voices in the legal literature that regard mandatory compliance with sustainability criteria (such as the ones prescribed in the above-mentioned EU directive) as a condition for importation not in conformity with Article XI GATT.[79]

Relevant Exceptions

Regulatory measures in need of justification under Article XX GATT might be motivated by environmental reasons, usually by the combat against climate change in a broad sense. Thus, differential treatment of biofuels and fossil fuels may occur owing to their particular contributions or threats to sustainability of feedstock cultivation, to biodiversity, to life-cycle carbon emissions and air pollution or to energy efficiency. This refers to concerns about the protection of human or plant life

[75]See Panel, *US – Restrictions on Imports of Tuna*, DS 21/R, para. 5.10 et seq.; Panel, *US – Restrictions on Import of Tuna*, DS29/R, para. 5.16–5.18, and Matsushita/Schoenbaum/Mavroidis, *The World Trade Organization*, (2nd ed.) 2006, pp. 240–41, 244–45.

[76]van den Bossche, *The Law and Policy of the WTO*, (2nd ed.) 2008, p. 447.

[77]Accord Mavroidis, *Trade in Goods*, 2007, p. 60.

[78]Pauwelyn, Rien ne Va plus? Distinguishing Domestic Regulation from Market Access in GATT and GATS, World Trade Review 4 (2005), pp. 131 et seq. (147). See also Howse/Regan, The product/process distinction – An illusory basis for disciplining "unilateralism" in trade policy, EJIL 11 (2000), p. 249; Herrmann/Weiß/Ohler, *Welthandelsrecht*, (2nd ed.) 2007, mn. 519.

[79]E.g. Aidelojie/Makuch, Multilateral Organisations, Fossil Fuels and Energy Law and Policy: The Tower of Babel revisited, European Energy and Environmental Law Review 2008, pp. 227 et seq. (247). This approach is also taken by Brühwiler/Hauser, Biofuels and WTO disciplines, Aussenwirtschaft 63 (2008), pp. 7 et seq. (27), who opine that if unsustainably produced biofuels are entirely barred from import, this amounts to a prohibited quantitative restriction.

or health and the conservation of exhaustible natural resources (such as clean air[80]). Such public policy objectives are covered by Article XX GATT. The paragraphs most relevant in the case of favourable treatment of (certain) biofuels are (b) and (g). Additionally, domestic measures could be motivated by the attempt to secure compliance with laws or regulations not inconsistent with GATT (lit. (d)). The latter paragraph might offer a justification for certification schemes pursuing social policy objectives such as compliance with labour standards and consumer protection.[81] Measures which favour domestic biofuels or feedstock over imported biofuels or feedstock may also be based on a need to create a strong domestic biofuels industry. Such policy could be justified under lit. (j) as regards measures essential to the acquisition or distribution of products in short supply. One could even think of the national security exception of Article XXI (b) GATT. The applicability of the latter, however, requires a state of war or other emergency in international relations. One could also think of the need for a national biofuels industry as a contribution to energy supply security. As energy security is contained in Article XXI GATT only under the conditions there (in particular requiring a state of war or other international emergency) energy security requirements could be subsumed under Article XX (d) GATT.

For a measure to be in conformity with the different paragraphs of Article XX GATT, the specific requirements of each individual paragraph have to be met, which are different. Whereas paragraph (b) prescribes that a measure must be necessary to protect human or plant life, paragraph (g) only requires that the measure relates to the conservation of exhaustible resources, which is a lower standard since the necessity test calls for an assessment of whether there is a less trade restrictive alternative means reasonably available to the regulating WTO member. On the other hand, measures can be justified under paragraph (g) only if they are made effective in conjunction with restrictions on domestic production or consumption. If a regulatory requirement only affects imported goods so that no restrictions on domestic like products are imposed at all, it amounts to a naked discrimination against imported goods for protecting local goods.[82]

With regard to Article XX (b) GATT, the Appellate Body recently opined that even a severe restriction to international trade such as an import ban may be justified and meet the necessity test if it materially contributes to the achievement of its objective. This must be demonstrated either by quantitative projections in the future or by qualitative reasoning based on sufficiently evidenced hypotheses. With regard to climate change, the Appellate Body added that certain actions could only be evaluated with the benefit of time as "complex public health or environmental

[80]Appellate Body, *US – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R.

[81]Contra Zarrilli/Burnett, Certifying biofuels: benefits for the environment, development and trade?, in Cottier/Nartova/Bigdeli (eds.), *International Trade Regulation and the Mitigation of Climate Change*, 2009, pp. 197 et seq. (223).

[82]See Appellate Body, *US – Gasoline*, WT/DS2/AB/R, p. 21.

problems may be tackled only with a comprehensive policy comprising a multiplicity of interacting measures".[83]

Exigencies of the Chapeau of Article XX GATT

WTO members that want to adopt measures covered by legitimate public policy objectives as enshrined in Article XX GATT must take care that their measures are also in conformity with the exigencies of the chapeau of Article XX GATT, which obliges the application of the regulatory regimes not to constitute arbitrary or unjustifiable discriminations between countries where the same conditions prevail or disguised restrictions on international trade. As the aim of the chapeau is to prevent abuse of the exceptions under Article XX GATT and as the chapeau refers to the application of the regulatory measure, it is first of all important for WTO members to take care that the regulatory requirements are also administered and applied in a non-discriminatory manner. The standard of non-discrimination required by the chapeau is different from Article III:4 GATT, otherwise Article XX could not apply to violations of Article III:4 GATT. The exceptions enshrined in Article XX can, however, justify even discriminations against foreign like products if the discrimination is needed to accomplish the legitimate public policy aim. Thus, the chapeau stipulates requirements of transparency and due process. WTO members introducing regulations should take care that their regulations do not treat differently imported products from countries where the same conditions exist. The regulations must be responsive to the conditions in other WTO members. To impose domestic criteria which are not specified in an objective way and which do not consider the comparability of regulatory measures taken in the exporting WTO member may be held unjustifiably discriminatory.[84] Thus, the chapeau stipulates some procedural requirements which compel WTO members to consider also foreign interests. As a consequence, regulatory regimes have to be sufficiently flexible to take the situations of others into account and consider foreign programmes of comparable effectiveness.[85] Unjustifiable discrimination might also exist where specifications and conformity assessment procedures are based on specific properties of domestic feedstock or biofuels, or where some WTO members agree on mutually compatible biofuels-related standards to the exclusion of others.

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[83]Appellate Body, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, para. 150 et seq.

[84]See also Brühwiler/Hauser, Biofuels and WTO disciplines, Aussenwirtschaft 63 (2008), pp. 7 et seq. (28).

[85]von Bogdandy, Legitimacy of International Economic Governance: Interpretative Approaches to WTO law and the Prospects of its Proceduralization", in: Griller (ed.), *International Economic Governance and Non-Economic Concerns*, 2003, pp. 103 et seq. (136).

Process and Production Methods and Inherent Jurisdictional Limitations

Another issue already alluded to is the justifiability of measures which have an extraterritorial effect. The question is whether Article XX GATT contains an inherent jurisdictional limitation to the effect that the actions of a regulating WTO member may not impact on the domestic regulatory policy of exporting WTO members if and only insofar as the importing member regulates requirements which have no impact on the physical or chemical characteristics of the imported good but relate to process or productions methods only which were used/applied in the exporting WTO member in conformity with the latter's regulations. In other words: Can Article XX GATT be invoked to protect values *outside the territorial jurisdiction* of the regulating WTO member?[86] According to a GATT panel in the *US – Tuna* case, Article XX GATT cannot justify a unilateral attempt to prejudge behaviour outside the jurisdictional limits of the regulating state.[87] The issue was revisited in the *US – Shrimp* case, where the Appellate Body opined that the measures were not, merely because of their unilateral character, inconsistent with Article XX GATT.[88] The Appellate Body, however, did not pass upon the question whether there is an implied jurisdictional limitation. It escaped from giving a clear-cut answer by referring to the fact that the species to be protected by the US measure (sea turtles) migrate and traverse waters subject also to the jurisdiction of the USA, so "in the specific circumstances of the case.... there is sufficient nexus between the migratory and endangered marine populations involved and the US for the purposes of Article XX (g)".[89] This issue, however, is of core importance in the case of PPM requirements which have no impact on the characteristics of the good or on the use of the good within the territory of the importing member state. Regulatory measures regarding biofuels which differentiate among them owing to their different contributions to biodiversity or other environmental impacts within the territory of the exporting member might be confronted with such objections against the application of Article XX GATT. Anyway, such contestations may easily be refuted if the regulating WTO member can show that the PPM requirements pursue policy objectives also with regard to territorial impacts on their environment or on global commons.

[86]The intricate issue of which type of regulation could be defined as extraterritorial cannot be addressed here. For a rather limited notion see Vranes, *Trade and the Environment*, 2009, pp. 166 et seq. (181), who categorizes process-based trade measures usually not to be extraterritorial because they do not directly regulate conduct on foreign territory but make the actual application of the regulatory requirements dependent on the act of importation.

[87]Panel, *US – Restrictions on Import of Tuna*, DS21/R, para. 5.27, 5.32.

[88]Appellate Body, *US – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, para. 121 –; see Panel, *US – Restrictions on Import of Tuna*, DS29/R, para. 5.16–5.20.

[89]Appellate Body, *US – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, para. 133.

SPS and TBT Disciplines

Whereas the exigencies of GATT law mainly prescribe for non-discrimination of imported goods, the TBT and SPS agreements prescribe for further leading, more demanding obligations which contain specific disciplines on domestic regulations, in particular as they require the domestic regulations not to be more trade-restrictive than necessary (Article 2.2 TBT) and to be based on sufficient scientific evidence (Article 2.2 SPS).

TBT Agreement

The TBT agreement applies to technical regulations, non-binding standards and rules on procedures for assessment of conformity with regulations or standards. Thus, the obligations enshrined in the TBT agreement are also relevant for regulations and standards on biofuels. Since technical regulations are considered to be regulations on product characteristics or their related processes and production methods, including related packaging, marking and labelling requirements, the TBT disciplines may be relevant in particular to regulations that differentiate because of PPMs. Still subject to debate, however, is the question whether the TBT applies to all types of PPM requirements or only to those that impact on the product characteristics so that PPMs unrelated to product characteristics are not covered by the TBT disciplines. Besides the negotiating history,[90] it is the wording in Annex 1 that speaks in favour of the limited scope of the TBT because technical regulations are defined as “product characteristics or their related processes and production methods”, so PPMs unrelated to product characteristics appear to be excluded. It has been contended, however, that it would not make sense to scrutinize product-related PPMs under the TBT and the non-product-related PPMs under the GATT, all the more since non-product-related PPMs might be the less transparent and more trade restrictive requirements to which the allegedly stricter rules of the TBT would not apply.[91] Although it is right that the difference between product-related and non-product-related PPMs might not be so great as to justify the applicability of a different set of rules, it is doubtful whether primary substantive TBT disciplines (i.e. those apart from the reporting and notification requirements in Article 10 and the detailed requirements for conformity assessment in Article 5) really are so much stricter than general GATT disciplines.[92] Anyway, although the difference in treatment could be seen as the consequence of the wording of

[90]See Committee on Trade and Environment, WT/CTE/W/10; Joshi, Are Eco-Labels Consistent with WTO agreements?, J.W.T. 38 (2004), pp. 69 et seq. (74).

[91]Zarrilli/Burnett, Certifying biofuels: benefits for the environment, development and trade?, in: Cottier/Nartova/Bigdeli (eds.), *International Trade Regulation and the Mitigation of Climate Change*, 2009, pp. 197 et seq. (212).

[92]See Vranes, *Trade and the Environment*, 2009, pp. 316–317, 340.

Annex 1, the very wording is not so compelling as to definitely exclude non-product-related PPMs.[93] The even-handedness of the legal yardstick for assessing PPMs under the TBT is a central argument in favour of a uniform application of the TBT to all type of PPMs.

TBT disciplines also require the WTO members to base their technical regulations on international standards (Article 2.4). International standardization for biofuels is on its way, but currently there are only few standards, such as ISO standards on testing of characteristics in substances.[94] A first pilot version of international standards for better biofuel production was released by the Roundtable on Sustainable Biofuels (RSB) recently. It is the first large-scale effort to create global principles and criteria for sustainable biofuel production which envisages an environmental and social impact assessment and contains respective guidelines for conducting the assessment.[95] Other instruments relevant for biofuels are the Roundtable on Sustainable Palm Oil Production (RSPO) supply chain certification systems. The TBT, however, requires an international standard to be approved by governmental bodies or non-governmental bodies having the power to enforce regulations (Annex 1 (8)). Hence, standards developed by the RSB or the RSPO may not be covered by the TBT agreement.[96]

Domestic regulations which conform to international standards are subject to a rebuttable presumption that such measures do not create unnecessary obstacles to international trade (Article 2.5 TBT). With regard to regulations not in conformity with international standards, it has to be established that they are not more burdensome on trade than necessary to fulfil legitimate objectives such as protection of human health or animal or plant life or health or the environment. Thus, Article 2.2 TBT justifies the pursuance of similar objectives as does Article XX GATT but always stipulates a necessity test, the standards of which might be the same as under Article XX (b) GATT. The requirements of the necessity standard under Article 2.2 TBT have not yet been decided upon by GATT/WTO jurisprudence.

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[93] See also Marceau/Trachtman, A Map of the World Trade Organization Law of Domestic Regulation of Goods, in: Berman/Mavroidis (eds), *Trade and Human Health and Safety*, 2006, pp. 9 et seq. (59); Vranes, *Trade and the Environment*, 2009, pp. 338–340.

[94] Switzer, International Trade Law and the Environment: Designing A Legal Framework To Curtail the Import of Unsustainably Produced Biofuels, Journal of International Trade Law and Policy 6 (2007), pp. 30 et seq. (41).

[95] http://www.cgse.epfl.ch/page84341.html (accessed 7 January 2010); Zarrilli/Burnett, Certifying biofuels: benefits for the environment, development and trade?, in Cottier/Nartova/Bigdeli (eds.), *International Trade Regulation and the Mitigation of Climate Change*, 2009, pp. 197 et seq. (206 et seq.).

[96] S. Zarrilli/Burnett, Certifying biofuels: benefits for the environment, development and trade?, in Cottier/Nartova/Bigdeli (eds.), *International Trade Regulation and the Mitigation of Climate Change*, 2009, pp. 197 et seq. (213).

SPS Agreement

The SPS agreement contains obligations which are more specific than the TBT agreement as they apply to sanitary and phytosanitary measures, a subset of technical regulations (see Article 1.4 SPS, Article 1.5 TBT), which also means that the SPS does not apply to non-mandatory standards, in contrast to TBT. The SPS agreement also has precedence over GATT by virtue of Article 2.4 SPS, so measures cannot be challenged under GATT disciplines insofar as they are in conformity with the SPS. Thus, the SPS agreement is *lex specialis* but only concerning sanitary or phytosanitary measures, i.e. measures addressing particular risks for domestic[97] human, animal or plant life or health or for the domestic environment[98] as defined in Annex A (1) to the SPS stemming from trade in animals, plants, food or feed or even biomass or biowaste (though not explicitly mentioned in Annex A). If such measures engender other risks not specifically dealt with in the SPS, the TBT or GATT disciplines still apply because insofar there is a non-SPS measure.[99]

The SPS disciplines may be relevant for measures regarding biofuels as they are made from plants. Thus, domestic measures may be directed inter alia against risks covered by the SPS. Again, requirements with regard to PPMs are covered (without any reference point for a limitation to product-related ones only). The SPS may become relevant if WTO members adopt measures restraining trade with or the use of genetically modified organisms (GMOs), in particular regarding feedstock as a raw material for biofuels. A ban on biofuels made from GMOs can be subsumed under the definitions of Annex A despite its reference to very specific, narrowly defined risks[100] because the panel in the *EC – GMO* case gave a broad reading to the term "pest" contained in Annex A (1). According to this panel, "pests" means all animals or plants which cause harm to other plants or animals because of the invasiveness, the unintended gene flow and growing pesticide-resistance potentially caused by GMOs.[101]

The SPS disciplines are comparable to those of the TBT: the members may adopt or maintain measures only to the extent necessary to pursue the legitimate objective, i.e. not more burdensome on international trade than required (see Articles 2.2,

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[97]SPS only applies to measures that protect health within the territory of the regulating WTO member (thus, there is a clear jurisdictional limitation, in contrast to the debate under Article XX GATT). Nevertheless, the regulation of the importing WTO member can impact on the production methods in the exporting WTO member if they impact on the health situation in the importing WTO member, see Marceau/Trachtman, A Map of the World Trade Organization Law of Domestic Regulation of Goods, in: Berman/Mavroidis (eds.), *Trade and Human Health and Safety*, 2006, pp. 9 et seq. (60).

[98]See Annex A (1) (d) and Panel, *EC – GMO*, WT/DS291/R, WT/DS292/R, WT/DS293/R, para. 7.209.

[99]Panel, *EC – GMO*, WT/DS291/R, WT/DS292/R, WT/DS293/R, para. 7.165–7.167.

[100]This point was raised by the EC in the EC – GMO case, see Panel, WT/DS291/R, WT/DS292/R, WT/DS293/R, para. 7.185–7.187; see also Herrmann/Weiß/Ohler, *Welthandelsrecht*, (2nd ed.) 2007, mn. 598.

[101]Panel, *EC – GMO*, WT/DS291/R, WT/DS292/R, WT/DS293/R, para. 7.239–7.242.

5.6 SPS). In addition to the TBT, however, the measures must be based on scientific principles and evidence and subject to a scientifically based risk assessment (Article 2.2 in conjunction with Article 5 SPS). Again, if a measure conforms to international standards, guidelines or recommendations promulgated by international organizations (see Annex A (3); insofar the SPS is even more rigorous than the TBT), it is deemed to be necessary for the protection of human, animal or plant life and health (Article 3.2 SPS). Thus, scientific expertise becomes the yardstick for SPS measures, as confirmed by the role science plays in WTO jurisprudence regarding the SPS. Hence, WTO members must take care that their regulatory requirements are scientifically tenable. Members have to consider investigating also measures other than the measure chosen; risk assessment must not be limited to the measures adopted.[102]

The WTO members' leeway to define policies and to adopt the measures deemed necessary for the protection against the risks defined in Annex A (1) to SPS appears to be more limited than under GATT and TBT. Even precautionary measures under Article 5.7 SPS[103] which members may apply transitionally owing to an insufficiency of scientific evidence are faced with some hurdles: In the *Japan – Apples* case, the Appellate Body opined that recourse to Article 5.7 SPS is only available for members if scientific evidence is insufficient (meaning that available scientific evidence does not allow a risk assessment in quantitative or qualitative terms[104]), not if there is scientific uncertainty[105] – a dichotomy which is difficult to draw. Additionally, a WTO member adopting a provisional measure has to identify the insufficiencies in the scientific evidence and the necessary steps to be taken to address these deficiencies and to make a more objective assessment with a view to reviewing the provisional measure within reasonable time.[106] The WTO members, however, are free to determine the level of protection they deem necessary. They can even choose to set a higher level of protection than would be achieved by measures based on international standards.[107] The fact that an international standard was based on scientific risk assessment does not establish a legal presumption of sufficiency and does not mean that there could not be insufficiencies in the scientific

[102]See Appellate Body, *Japan – Measures Affecting the Importation of Apples*, WT/DS245/AB/R, para. 208.

[103]The precautionary principle is reflected in Article 5.7 SPS, Appellate Body, *US – Continued Suspension of Obligations in the EC Hormones Dispute*, WT/DS320/AB/R, para. 680.

[104]Appellate Body, *Japan – Measures Affecting the Importation of Apples*, WT/DS245/AB/R, para. 179.

[105]Appellate Body, *Japan – Measures Affecting the Importation of Apples*, WT/DS245/AB/R, para. 184.

[106]Appellate Body, *US – Continued Suspension of Obligations in the EC Hormones Dispute*, WT/DS320/AB/R, para. 679; the WTO member adopting a provisional measure bears the burden of proof as regards the insufficiencies in the existing scientific evidence which precluded it from performing an objective risk assessment, para. 716.

[107]Appellate Body, *US – Continued Suspension of Obligations in the EC Hormones Dispute*, WT/DS320/AB/R, para. 685.

evidence where a member intends a higher level of protection or where there are subsequent scientific developments.[108] In particular, where a member aims for a higher level of protection the presumption in Article 3.2 SPS is inapplicable.[109]

Subsidies

Biofuels and WTO Subsidy Regime

The demand for biofuels in industrialized countries mainly depends on the political will to promote the use of biofuels. One of the instruments of environmental politics is domestic subsidies to foster the consumption and production of biofuels, besides mandatory blending requirements. In particular, the production of biofuels in industrialized countries receives considerable subsidization as the production costs are much higher than in developing or emerging countries owing to the temperate climate. The subsidization of consumers is a viable means of providing them with an incentive to switch from fossil fuels to biofuels.

Subsidization of biofuels is problematic both under the AoA, which contains additional rules for subsidies on agricultural products such as ethanol (see above), and under the generally applicable SCM. Under the SCM, subsidies are actionable; only few are prohibited under Article 3 SCM. Article 3 SCM prohibits export subsidies or subsidies contingent upon the use of domestic over imported goods. The latter might become relevant if the subsidization of biofuel production is made dependent on the use of domestically produced feedstock instead of imported feedstock.[110]

Subsidies either can be challenged before the dispute settlement system (see Articles 4 and 7 SCM) or are the subject of unilateral countervailing duties (CVDs) to offset the benefit of a subsidy (see Article 10 et seq.). CVDs require proof of injury caused or a threat of injury to the domestic industry of another member by subsidized imports of competing products (see Article 11.2 iv) SCM). This means that the subsidy undercuts the price of a like product or increases the market share of the subsidized goods (see the criteria of Article 6.3 SCM defining a serious prejudice of the interests of other members). This could happen if the subsidy enables producers to export at low prices or impedes imports owing to the subsidized domestic price level.[111]

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[108] Appellate Body, *US – Continued Suspension of Obligations in the EC Hormones Dispute*, WT/DS320/AB/R, para. 694 et seq.

[109] Appellate Body, *US – Continued Suspension of Obligations in the EC Hormones Dispute*, WT/DS320/AB/R, para. 710.

[110] Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 16.

[111] Harmer, Biofuels subsidies and the law of the WTO, ICTSD Agricultural Trade and Sustainable Development, Issue paper 20, June 2009, p. 9.

The AoA contains additional rules which distinguish basically between two regimes for subsidies. The ones falling under the Green Box are subsidies provided by a publicly funded programme which do not provide price support to producers and meet the criteria specified in Annex 2 to the AoA. Annex 2 specifies further conditions which R&D subsidies, subsidies for general services and infrastructure or subsidies for environmental purposes have to meet, which may include conditions related to production methods or inputs. Green Box subsidies are allowed as their trade or production distortion is deemed only minimal, if at all. The Green Box is not a broad and comprehensive category for subsidies for environmental or development reasons but its categories stipulate specific requirements (see III.).[112] If the Green Box requirements are not met, the subsidies fall under the Amber Box, which means that they are subject to ceilings and domestic support reduction commitments of each member and must be notified to the WTO (Article 7 AoA).

Notion of Subsidy

The applicability of both the SCM and the AoA requires that a subsidy meets the criteria set out in Article 1 SCM: accordingly, a subsidy is a *financial contribution* (in whatever way) providing a *benefit* (an advantage compared with competitors or a discharge which the recipient normally has to carry) which is *specific*, i.e. legally or de facto directed to a certain enterprise or industry or group of enterprises or industries (Article 2 SCM). A de facto specificity applies if the subsidy programme is not explicitly addressed to specific undertakings but is worded in an objective way where it, however, turns out in practice that the programme is used by a limited number of certain enterprises or where disproportionately large amounts of subsidy are granted to certain enterprises (see Article 2.1 lit. (c) SCM). Thus, tax rebates, tax credits and tax holidays specifically directed towards biofuel producers are specific benefits.

The decisive issue as regards tax rebates is the question as to whether biofuel producers receive benefits compared with the systemic criteria and general policies and principles applied by the domestic tax system in calculating the tax burden which have to be looked at in order for it to be determined which tax burden "otherwise due is foregone or not collected" (Article 1.1 lit. (a) (1) (iii) SCM). Thus, if tax authorities forego revenue otherwise due, a tax credit for biofuel producers is a subsidy. If a WTO member would like to favour biofuel producers over fossil fuel producers, the lawful way then is not to introduce tax rebates for certain undertakings but to alter the criteria according to which the actual tax burden is calculated, for example by introducing an environmental component which considers environmentally important factors in the determination of the tax burden, such as

[112] Harmer, Biofuels subsidies and the law of the WTO, ICTSD Agricultural Trade and Sustainable Development, Issue paper 20, June 2009, p. 10.

the environmental properties of each type of fuel. As a consequence, although an environmentally motivated tax rebate may be challengeable under the SCM or AoA, the introduction of new environmentally oriented principles into the domestic tax system is not. The WTO members are free to define the general guidelines and principles of their national tax systems (provided that they are in conformity with Article III GATT, see above). A WTO member enjoys the "sovereign authority to tax any particular category of revenue it wishes".[113] The benefit is determined by applying the general domestic standards of each WTO member. Thus, WTO members can tailor their general principles in a way that favours environmentally friendly goods and/or production processes.[114]

Another issue which has been debated in the context of subsidized Canadian lumber and which could become meaningful in the context of biofuels subsidies as well[115] is the question as to how in the *determination of a benefit* the fact that market prices and conditions were intensely precoined by public interventions has to be considered. The determination of a benefit requires proof of an advantage compared with the usual market conditions. It is uncontested that the adequacy of the remuneration has to be determined in relation to the prevailing market conditions for the good in question.[116] In the Canadian lumber case, the USA contended that the point of comparison was the prevailing commercial market conditions, i.e. conditions undistorted by public contributions.[117] The Appellate Body confirmed the panel's view that market conditions need not be pure market conditions[118] and that private prices normally are the primary benchmark, but added that a benchmark other than private prices may be used if private prices are distorted because of the government's predominant role,[119] for example due to administrative price controls or by the state being the only supplier[120] or being the price-setter.[121]

Benefits are only actionable if specifically *directed to an enterprise or industry*. Thus, subsidies paid to the consumers, for example incentives to use biofuel instead

[113]Appellate Body, *US – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, para. 90.

[114]See also Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 19.

[115]See Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 17.

[116]Panel, *US – Final CVD Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/R, para. 7.46.

[117]Panel, *US – Final CVD Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/R, para. 7.50.

[118]Appellate Body, *US – Final CVD Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, para. 87.

[119]Appellate Body, *US – Final CVD Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, para. 90.

[120]Appellate Body, *US – Final CVD Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, para. 97

[121]Appellate Body, *US – Final CVD Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, para. 100.

of fossil fuels, are not covered. Furthermore, in such a case, the benefit, even if one could see it as an indirect, upstream benefit specifically targeting the biofuel production, will still not be a subsidy in the sense of Article 1 SCM because it does not confer an advantage on the biofuel producers "within the jurisdiction of the granting authority" as required by Article 2.1 SCM. The incentive to the consumer applies irrespective of the origin of the biofuel. The incentive can be seen as a subsidy only if it is made dependent on the consumption of domestically produced biofuel. Only in the latter case would the incentive afford a competitive advantage to domestic producers only.[122]

A further issue in the context of specificity is the problem of *pass-through benefits*. Subsidies granted to peculiar industries might prove to be subsidies as well to other industries as the latter might benefit from cheaper prices owing to lower production costs for commodities, raw materials and other inputs. The recipient of the initial, direct financial contribution and the receiver of the competitive benefit need not necessarily be identical or vertically integrated; they can be different as Article VI:3 GATT refers to both direct and indirect subsidies and as there is no postulate of identity in Article 1.1 SCM which requires a financial contribution and a benefit thereby conferred without indication of to whom the benefit is conferred.[123] This issue is of particular relevance in the biofuel sector if subsidies are directed towards feedstocks used as input for biofuels. If the domestic subsidy regime favours all agricultural products and not only specific ones needed as the basis for biofuel production, it is a general subsidy beneficial to all processing industries and not specific for certain industries (though it is a subsidy for the farmers). Things become complicated if feedstocks are subsidized only if they are processed into biofuels, or if the subsidization concerns the production of certain feedstocks/commodities that could only be used for producing biofuels. In the latter cases one could argue that subsidies for feedstocks are downstream subsidies to those specific enterprises which process these feedstocks into biofuels. Specificity, however, requires that the subsidies are specific to enterprises within the domestic jurisdiction. This means that if the subsidized feedstock can also be purchased and processed by foreign biofuel producers, there is no specific advantage to domestic producers. One might object that owing to transportation costs only domestic industries practically will be in a position to enjoy the subsidized prices for inputs.[124] Such objection, however, depends on the facts of the case at hand. It might prove that the industries also of at least some other WTO members, in particular neighbouring ones, can benefit as well. The legal assessment is different if domestic subsidy regimes grant the financial contribution to feedstock producers only if they sell their feedstock to domestic biofuel producers. In such a case there is

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[122]See Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 20.

[123]Appellate Body, *US – Final CVD Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, paras. 124, 129 and 140.

[124]As Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 20 opines.

a clear specificity. The complaining WTO member then has to establish for the input product the existence of a financial contribution and a conferral of a benefit to the input producer as well as that the benefit resulting from the subsidy has passed through, at least in part, downstream to benefit indirectly also the processed product.[125] This can be presumed if the feedstock grower and the biofuel producer are related and so a pass-through analysis is not required.[126]

Closely related to the issue of pass-through benefits is the issue of *cross-subsidization*. Subsidies to increase biofuel production and the demand for biofuels engender side effects for by-products resulting from the production of biofuels, for example an increase in production of glycerol as a by-product of biodiesel. Biodiesel producers might use their strengthened position to sell glycerol and other by-products at cheaper prices, which might be assessed as being subsidized by competitors. To avoid such assessment, WTO members introducing domestic subsidy schemes should ensure that the subsidy biofuel producers receive is consumed solely for the production of biofuels and that cross-subsidization of other products can be excluded, for example by separate accounting. If such cross-subsidization is not prevented, WTO members whose exports of by-products are affected by the subsidy not only face reduced market chances on the market of the subsidizing WTO member but are also confronted with new competitors on their own domestic markets owing to an increase of overall production. Thus, they might complain that the subsidized biofuel producers cause injury to their domestic markets.[127]

Biofuel Subsidies and Agricultural Green Box

The Green Box exempts certain domestic subsidies from the ceilings and reduction commitments if they meet the criteria in Annex 2 of the AoA. Accordingly, the subsidies must be publicly funded without involving transfers from consumers, must not provide price support to producers and must meet policy-specific criteria. Thus, subsidies for agricultural feedstocks, for example, could be considered under Annex 2 of the AoA, paragraph 12 as payments under an environmental programme if they are part of a "clearly defined governmental environmental or conservation" programme which might impose conditions related to production methods, for example by proscribing sustainability criteria in the production of feedstock. But even in this case, the financial contribution has to be limited to the extra costs involved in complying with the government programme. Thus, the payment may

[125] Appellate Body, *US – Final CVD Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, paras. 142 et seq.

[126] See Panel, *US – Preliminary Determinations with Respect to Certain Softwood Lumber from Canada*, WT/DS236/R, paras. 7.71–7.72.

[127] Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 22.

only compensate for additional costs. This requirement clearly constrains the level of possible subsidies.

Subsidies for R&D in biofuels could be privileged under paragraph 2 of Annex 2 of the AoA. The constraining factor insofar, however, is the requirement that such subsidies shall not involve direct payments to producers or processors. Hence, the general services category of the Green Box does not appear to be very attractive.

Another category of interest here is a policy of decoupled import support which could favour direct payments to biofuel feedstock farmers. Paragraph 6 lit. (b) in Annex 2 of the AoA, however, demands that such payments are not related to or based on the type or volume of production. Thus, a payment that depends on a switch of production from fruits or vegetables to biofuel crops will not conform to the requirements.[128]

A further possibility is to consider financial contributions to feedstocks relevant for biofuel production under Annex 2 of the AoA, paragraph 10 as a structural adjustment and resource retirement programme designed to remove land from marketable agricultural production. Biofuel is not an agricultural product, at least as regards biodiesel. Thus, if agricultural land is used to grow feedstock for second-generation biofuels which are not made from agricultural products, this category would apply. With regard to ethanol, which is classified as an agricultural product, things are more complicated because insofar the feedstock still could be seen as being used for agricultural production.[129] Agricultural crops may have also industrial non-food uses, but the possibly different end uses of agricultural products do not play a role under this paragraph.[130]

Conclusion

The above tour d'horizon regarding the meaning of the most relevant WTO disciplines for measures adopted with regard to biofuels which could impact on the cross-border trade of biofuels has evidenced that although there are still intricate issues as regards the interpretation and application of WTO disciplines to biofuels, WTO members enjoy a considerable policy space for adopting a policy fostering production and consumption of biofuels deemed necessary for the protection of the

[128]See Appellate Body, *US – Subsidies on Upland Cotton*, WT/DS267/AB/R, paras. 325, 329, 341–342.

[129]Contra Howse et al., WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006, p. 21, with the argument that the HS classification of ethanol does not reflect its use as a biofuel. Although this point is correct, the AoA has a clear definition with regard to what is regarded as an agricultural product in Annex 1. It is not very convincing to apply to Annex 2 a definition of agricultural production different from that in Annex 1.

[130]See Harmer, Biofuels subsidies and the law of the WTO, ICTSD Agricultural Trade and Sustainable Development, Issue paper 20, June 2009, p. 11.

environment and the reduction of greenhouse gases, for energy supply security and for protection of human health and biological diversity provided that they carefully design and formulate their regulations. WTO law, in principle, allows for domestic sustainability criteria and certification schemes. It also allows for non-trade-distorting subsidies that contribute to the pursuance of environmental and other objectives. It is advisable to prefer standards based on a product's performance over requirements prescribing particular contents or descriptive characteristics[131] and to use precise and well-defined criteria. Some uncertainties remain in particular as regards the treatment of PPM requirements which play a particular role in sustainability requirements. Both for PPM stipulations as well as for other more product-related criteria for ensuring the environmental sustainability of biofuels, WTO members have to take care that the criteria are transparent and scientifically verifiable, operate in an objective way and are flexible enough to apply to comparable conditions in other WTO members and to consider the equivalence of their regulatory schemes. The criteria should not be tailored according to specific characteristics of domestic industries or products because in such a case they might be assessed more easily as a disguised restriction of trade so that a de facto discrimination cannot be justified under Article XX GATT or might violate Article 2.3 SPS. Within these confines, which are necessary to strike the right balance between combating protectionism and pursuing legitimate public policy objectives, WTO members have to seek the most effective and least trade distorting ways of promoting biofuels.[132] A concern not answered by this is whether industrialized nations by their biofuels policy run into the new trap of environmentally based agricultural protectionism.[133]

The legal security about the conformity of sustainability measures with WTO disciplines doubtlessly would increase with the advent of international standards on sustainable biofuels. The current endeavours on international standards by civil society, industry and producers, for example within the RSB, are not helpful in this regard because in a strict view they must be regarded as private schemes not covered by the TBT or SPS agreements, so their presumptions of lawfulness do not apply. The increase of legal certainty by way of international standardization has the price of more uniform levels of risk protection and risk aversion.

[131]Echols, Biofuels Certification and the Law of the WTO, ICTSD Agricultural Trade and Sustainable Development, Issue paper 19, August 2009, p. 33.

[132]Kaditi, Bio-energy policies in a global context, Journal of Cleaner Production 17 (2009) Supplement 1, p. S4 et seq. (S8).

[133]A warning was uttered by Brühwiler/Hauser, Biofuels and WTO disciplines, Aussenwirtschaft 63 (2008) 1, p. 7 (33).

Climate Labelling and the WTO: The 2010 EU Ecolabelling Programme as a Test Case Under WTO Law

Erich Vranes

Introduction and Legal Background

Labelling as an Instrument of Climate Protection

Environmental labelling is increasingly used as an instrument of climate protection.[1] This is underlined, for example, by the EU climate change programme, in which various labelling schemes are employed. Cases in point are the EU's oft-discussed voluntary ecolabelling scheme, which takes a life-cycle approach, and its mandatory labelling scheme for cars.[2] A further example is the recent discussion on 'CO_2

This contribution draws on several chapters in Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, in particular pp. 172 et seq., 191 et seq., 223 et seq., 256 et seq., 302 et seq., 319 et seq., 342 et seq., 379 et seq.; updated in February 2010, it takes into account the new 2010 EU ecolabelling programme, which entered into force in February 2010, and which is described in the following (see pp. 209 et seq.).

[1]For an overview of measures employed in various countries see the pertinent database of the International Energy Agency, http://iea.org/textbase/pm/grindex.aspx (accessed 19 February 2010); see also Green, Climate Change, Regulatory Policy and the WTO. How Constraining are Trade Rules?, JIEL 8 (2005), pp. 143 et seq. (150 et seq.); Charnovitz, Trade and Climate: Potential Conflicts and Synergies, Pew Center Working Paper, 2003, pp. 4 et seq., available at http://www.noconference.pewclimate.org/docUploads/Beyond_Kyoto_Trade.pdf (accessed 19 February 2010); see also the study by the Swedish Kommerskollegium/National Board of Trade, *Climate and Trade Rules – Harmony or Conflict?*, 2004, pp. 39 et seq., available at http://www.kommers.se/upload/.../Climate%20and%20trade%20rules.pdf (accessed 19 February 2010).

[2]As a main pillar of its regulatory strategy for the car sector, the EU has adopted a directive providing for labels that inform consumers of the fuel economy and CO_2 emissions of new passenger cars (Directive 1999/94/EC of the European Parliament and of the Council of 13 December 1999 relating to the availability of consumer information on fuel economy and CO_2 emissions in respect of the marketing of new passenger cars OJ 2000 L 12/16); further climate-related labelling mechanisms are included in various other EU instruments, see, e.g., Article 7 of Regulation (EC) No 842/2006 of the European Parliament and of the Council of 17 May 2006 on

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_9, © Springer-Verlag Berlin Heidelberg 2011

backpacks' in the UK and Austria, i.e. labels on the amount of CO_2 emissions generated by the national and international transportation of foodstuffs.[3] After the dubious outcome of the multilateral 2009 Copenhagen Climate Conference,[4] the importance of instruments of this type may increase even further.

Both mandatory and voluntary labelling schemes risk contravening WTO law: whereas mandatory labels restrict market access for non-complying products, labels that are granted under a voluntary scheme are meant to improve the perceived attractiveness of products that are awarded the label;[5] hence, such labels may negatively affect the competitive conditions of other products, *possibly* disadvantaging imported products.

Labelling schemes according to which information on a product's environmental impacts over its life cycle is included in a pertinent label fall into the category of process-based labels. It is well-known to WTO experts that such labelling schemes – in particular those based on 'non-product-related processes and production methods'[6] – raise a considerable number of issues under WTO law.

This contribution examines the EU's voluntary ecolabelling scheme, which was revised in 2000[7] and 2010.[8] Owing to its life-cycle approach, which since the scheme's inception has taken into account, e.g., energy consumption during production and use (besides further environmental impacts), this scheme has been intensely debated in trade and academic circles since its first version was introduced in 1992.[9] The new 2010 EU scheme similarly considers the whole life cycle of products, including 'the most significant environmental impacts, in particular the

certain fluorinated greenhouse gases, OJ 2006 L 161/1, p. 1, which introduces a mandatory labelling scheme for fluorinated gases; the member states have instituted a series of different voluntary and mandatory labelling schemes, see, e.g., the preamble of Council Directive 92/75/EEC.

[3]On this see the information provided by the Austrian Ministry for the Environment, Der "CO_2-Rucksack" von Lebensmitteln, 2008, available at http://lebensmittel.lebensministerium.at/article/articleview/55395/1/1471 (accessed 19 February 2010); on CO_2 backpacks see also Schmidt, Carbon accounting and carbon footprint – more than just diced results?, International Journal of Climate Change Strategies and Management 1 (2009) 1, pp. 19–30, available at http://www.emeraldinsight.com/1756-8692.htm (accessed 19 February 2010).

[4]For a first analysis of this conference see International Institute for Sustainable Development, Earth Negotiation Bulletin 12 (2009) 459, pp. 1 et seq., available at http://www.iisd.ca/climate/cop15/ (accessed 22 February 2010).

[5]For a taxonomy of labelling schemes see pp. 211 et seq.

[6]For details on this notion see pp. 207 et seq.

[7]Regulation (EC) No 1980/2000 of the European Parliament and the Council of 17 July 2000 on a revised Community eco-label award scheme, OJ 2000 L 237/1.

[8]See Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1 (in the following, EU Ecolabel Regulation).

[9]Council Regulation (EEC) No 880/92 of 23 March 1992 on a Community eco-label award scheme, OJ 1992 L 99/1; on this see, e.g., Forgó, *Europäisches Umweltzeichen und Welthandel*, 1999; Tietje, Voluntary Eco-Labelling programmes and Questions of State Responsibility in the WTO/GATT Legal System, JWT 29 (1995) 5, p. 123 with further references.

impact on climate change'.[10] Therefore, and in view of the broad range of issues raised by it, this scheme presents a model test case under WTO law also for other climate-related labelling schemes and ecolabelling schemes more generally.

Process-Based Measures, Process-Based Labelling and WTO Law: The Main Questions

Labelling programmes such as the EU scheme that take into account a given product's environmental impacts raise a classic set of questions in WTO law: these revolve around the issue of whether and to what extent a WTO Member is allowed to introduce measures affecting trade in goods that are concerned with process and production methods (PPMs) which are not related to the goods concerned in the sense of bearing on their physical characteristics (non-product-related PPMs, or NPR PPMs).[11]

The notion 'NPR PPM requirements' is derived from the 1979 GATT Agreement on Technical Barriers to Trade[12] and primarily refers to measures that target the production of goods, i.e. the stage before they are placed on the market.[13] It is held by many WTO Members and a majority of publicists that such process-based measures are to be treated differently from product-related regulations under WTO law. Thus, it has repeatedly been held, for example, that physically similar products that differ only in their production or processing methods must be regarded as like products and must always receive identical treatment; this would incur the consequence that any measures that differentiate between like products on the basis of NPR PPMs would inevitably violate clauses such as Article III of the GATT.[14]

[10]Article 6(3) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1 (EU Ecolabel Regulation).

[11]On the notions of NPR PPMs and product-related PPMs see, e.g., Joshi, Are Eco-Labels Consistent with World Trade Organization Agreements?, JWT 38 (2004) 1, pp. 69 et seq. (73–74), who defines NPR PPMs as "measures that relate to processes that do not impart any distinguishing characteristics to the final product". See also the definition provided by Canada in a communication to the WTO Committee on Trade and the Environment ("Non-product-related (NPR) PPMs describe a process or production method which does not affect or change the nature, properties, or qualities of (nor discernible traits in or on) a product."; see Canada, Labelling and Requirements of the Agreement on Technical Barriers to Trade (TBT): Framework for informal, structured discussions. Communication from Canada, WTO Doc. WT/CTE/W/229, 23 June 2003).

[12]See, e.g., Charnovitz, The law of environmental "PPMs" in the WTO: debunking the myth of illegality, Yale Journal of International Law 27 (2002) 1, pp. 59 et seq. (65).

[13]See OECD, Processes and Production Methods (PPMs): Conceptual Framework and Considerations on Use of PPM-Based Trade Measures, OECD Doc OCDE/GD(97)137, 1997, pp. 10 et seq.

[14]See the brief discussion of views expressed in the literature in Pauwelyn, Recent Books on Trade and Environment: GATT Phantoms Still Haunt the WTO, EJIL 25 (2004), pp. 575 et seq. (585–586), who does not share this view himself. The view described seems to be taken also by Joshi, Are Eco-Labels Consistent with World Trade Organization Agreements?, JWT 38 (2004) 1,

It has also been argued that NPR PPM-based measures invariably have to be found to be de facto discriminatory, even when they are drafted in origin-neutral terms, on the basis that such measures alter competitive conditions.[15] Furthermore, it has been held that such measures need to be justified under the GATT, even if they are non-discriminatory; moreover, it has even been contended that justification may be impossible in respect of such measures.[16]

This doctrine, which treats products and processes differently, is often referred to as the 'product–process doctrine', even though – in view of the many variants just mentioned – there is no uniform doctrine. These various views have in common that they break with the GATT system as it relates to 'standard', i.e. product-related, measures, which, for example, are not questioned if they are neither de jure nor de facto discriminatory, and which can be justified if they discriminate against foreign products. With the entry into force of the TBT Agreement in 1995, the additional question has arisen whether this agreement applies to NPR PPM requirements. Although the product–process divide is relevant for the status, under WTO law, of NPR PPM-based measures in general, a closely related, but partly self-standing discussion has arisen as to the status of NPR PPM-based environmental *labelling* schemes, which serve to promote products that are perceived as environmentally friendly owing to their production and processing methods.

The afore-described issues are largely unresolved in WTO practice and academic debate.[17] Their importance is evident, however, given that measures addressing production requirements are significant tools of environmental policy-making in line, in particular, with the rectification-at-source principle. Thus, environmental PPM requirements, in general, and PPM-based labelling schemes, in particular, can be used to address *local* concerns in the regulating state or another state, *transboundary* pollution as well as transboundary living resources, and *global* concerns such as climate change and the protection of the ozone layer.[18] Hence, if process-based

pp. 69 et seq. (75 et seq., 79); Tietje, Voluntary Eco-Labelling programmes and Questions of State Responsibility in the WTO/GATT Legal System, JWT 29 (1995) 5, pp. 123 et seq. (139 et passim); and Okubo, Environmental Labeling Programs and the GATT/WTO Regime, Georgetown International Environmental Law Review 11 (1999) 3, pp. 599 et seq. (621 et passim).

[15]See Puth, *WTO und Umwelt. Die Produkt-Prozess-Doktrin*, 2003, pp. 251 et seq.

[16]On this see also Charnovitz, The law of environmental "PPMs" in the WTO: debunking the myth of illegality, Yale Journal of International Law 27 (2002) 1, pp. 59 et seq. (pp. 75 et seq. with extensive further references); Howse/Regan, The Product/Process Distinction – An Illusory Basis for Disciplining 'Unilateralism' in Trade Policy, EJIL 11 (2000) 2, pp. 249 et seq.; Hudec, The Product-Process Doctrine in GATT/WTO Jurisprudence, in: Bronckers/Quick (eds.), *New Directions in International Economic Law. Essays in Honour of John H. Jackson*, 2000, pp. 187 et seq.; Pauwelyn, Recent Books on Trade and Environment: GATT Phantoms Still Haunt the WTO, EJIL 15 (2004), pp. 575, 585 et seq.

[17]See Puth, *WTO und Umwelt. Die Produkt-Prozess-Doktrin*, 2003, p. 30 et passim; Pauwelyn, Recent Books on Trade and Environment: GATT Phantoms Still Haunt the WTO, EJIL 15 (2004), 575 et seq., 585 et seq.

[18]See OECD, Processes and Production Methods (PPMs): Conceptual Framework and Considerations on Use of PPM-Based Trade Measures, OCDE/GD(97)137, pp. 15 et seq.

measures affecting trade were prevented by WTO disciplines to a greater degree than product-related measures, the resulting structural imbalance might be perceived as problematic from an environmental point of view.

Overview of the 2010 EU Ecolabelling Scheme

The EU first introduced an ecolabelling scheme in 1992[19] and this has attracted considerable attention in the literature and international fora.[20] In 2000, the EU introduced a revised ecolabelling mechanism which built upon the principles, but abrogated the legal basis of the 1992 scheme.[21] Like the 1992 regime, this mechanism established a voluntary ecolabel award scheme that intended to promote products with a reduced environmental impact during their entire life cycle. Given that the 1992 and 2000 mechanisms did not prove successful,[22] the EU decided, in 2009, to amend the ecolabelling scheme once more.[23]

Like the former ones, the new 2010 mechanism pursues a life-cycle approach on a voluntary basis,[24] aiming at reducing the negative impact of consumption and production of products on the environment, health, climate and natural resources.[25] It is administered by the EU in cooperation with independent competent bodies of the member states[26] and the European Union Ecolabelling Board (EUEB).[27] Like its predecessors, it strives to promote products which appear more environmentally

[19]Council Regulation (EEC) No 880/92 of 23 March 1992 on a Community eco-label award scheme, OJ 1992 L 99/1.

[20]See, e.g., Forgó, *Europäisches Umweltzeichen und Welthandel*, 1999; Tietje, Voluntary Eco-Labelling programmes and Questions of State Responsibility in the WTO/GATT Legal System, JWT 29 (1995) 5, pp. 123 et seq. with further references.

[21]Regulation (EC) No 1980/2000 of the European Parliament and the Council of 17 July 2000 on a revised Community eco-label award scheme, OJ 2000 L 237/1.

[22]An impact assessment of the scheme revealed that it did not achieve its objectives as it suffered from low awareness of the label and slow uptake by industry; only 26 product groups were covered by this scheme, and merely around 500 companies were using this label. On this, see EU Commission, Proposal for a Regulation of the European Parliament and of the Council on a Community Ecolabel scheme, COM(2008) 401 final.

[23]See Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1, replacing Regulation (EC) 1980/2000.

[24]On the distinction between voluntary and mandatory labelling schemes as well as other classification criteria for such schemes, see pp. 211 et seq.

[25]See Recital 5 of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1 (EU Ecolabel Regulation).

[26]Competent bodies are defined as “the body or bodies, within government ministries or outside, [which are] responsible for carrying out the tasks provided for” in the EU ecolabelling regulation, see Article 4(1) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[27]See the following text.

friendly, during their entire life cycle, than other similar products[28] (for the purpose of the EU scheme, the term 'products' also encompasses services)[29]. Therefore, the Ecolabel criteria are set by reference to groups of similar products,[30] so only products with superior environmental performance within a given group may receive the EU label.[31] Relevant criteria are, in particular, a product's 'most significant environmental impacts' including the impact on climate change, nature and biodiversity, energy and resource consumption, emissions, as well as its durability and reusability, and social and ethical aspects.[32] Labels are to be awarded on the basis of continuously updated scientifically based information, taking into account appropriate internationally recognized standards.[33]

Relevant labelling criteria are set and reviewed in a procedure which involves the Commission, the Member States, competent bodies, the EUEB and other stakeholders. The EUEB consists of representatives of competent national bodies and other interested parties. Member states must ensure that the composition of the competent bodies, within ministries or outside, guarantee their independence and neutrality and that their rules of procedure warrant transparency and the involvement of all interested parties at the national level.[34] Following consultation of the EUEB, the Commission, Member States, competent bodies and other stakeholders, which have demonstrated relevant expertise, may initiate and lead the development or revision of EU Ecolabel criteria for a given product group.[35] Operators wishing to use the EU Ecolabel have to apply to the aforementioned competent bodies. They can do so also for products originating *outside* the EU.[36] Upon award of the label, the competent body is to conclude a *contract* with the applicant which lays down the terms of use of the label.[37] Ecological criteria were set out, already under the 2000 scheme, for the award of the Ecolabel for a series of products, including

[28]See, e.g., Recital 5 of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[29]See Article 2(1) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[30]Article 3(1) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[31]Recital 5 of the preamble of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[32]Article 6(3) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[33]Article 6 of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[34]Article 4(2) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[35]Article 4–8 of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[36]Article 9(1) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[37]Article 9 of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

personal and portable computers, television sets, dishwashers, washing machines and tourist accommodation services.[38]

Issues in WTO Law

Although the EU scheme also covers environmental labelling of services,[39] the present analysis focuses on labelling of goods for reasons of space constraints and the complexity of the issues that present themselves already in the goods sector. For the same reasons, and since these issues have been treated at length elsewhere, this contribution does not address the questions of the unilateral and purported extraterritorial character of NPR PPM-based measures and labelling schemes.[40] It first tries to classify the main types of labelling schemes, then turns to the question of the applicability of the GATT and the TBT Agreement to a voluntary labelling mechanism such as the EU scheme, and finally examines central issues in substantive WTO law.

Taxonomy of Labelling Schemes

Generally speaking, it is possible to categorize labelling schemes pursuant to three criteria, that is (1) the issue of government involvement (whether the scheme is administered by public authorities or is privately sponsored), (2) its legal effect (whether labelling is mandatory or voluntary) and (3) its scope (whether it applies to product-related characteristics and product-related PPMs, or whether it – also or exclusively – covers NPR PPMs).[41]

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[38]For an overview of the great number of legal acts see http://ec.europa.eu/environment/ecolabel (accessed 19 February 2010).

[39]See Article 2(1) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1, and the preceding section of the text.

[40]See Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 95 et seq., 172 et seq., 319 et seq.

[41]See Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 343 et seq., where the issues raised under these types of labelling schemes are discussed; see also Joshi, Are Eco-Labels Consistent with World Trade Organization Agreements?, JWT 38 (2004) 1, pp. 69 et seq.; and Trüeb, *Umweltrecht in der WTO*, 2001, pp. 448–449, who adopts essentially the same categorization, but refers also to other possible classifications in fn. 268; see also Okubo, Environmental Labeling Programs and the GATT/WTO Regime, Georgetown International Environmental Law Review 11 (1999) 3, pp. 599 et seq. for a slightly different categorization; Green, Climate Change, Regulatory Policy and the WTO. How Constraining are Trade Rules?, JIEL 8 (2005), pp. 143 et seq. (150); Buck/Verheyen, *International Trade Law and Climate Change – a Positive Way Forward,* 2001, pp. 15 et seq., available at library.fes.de/pdf-files/stabsabteilung/01052.pdf (accessed 19 February 2010);

Labelling schemes administered by public bodies can be subdivided into mandatory and voluntary ones. A labelling system is regarded as mandatory when the award of the label functions as a legally binding market access requirement; otherwise it is classified as voluntary.[42] A scheme which functions on a voluntary basis may nonetheless affect the competitive relationship between similar products, and it is normally even meant to bring about this effect: this follows from the common understanding that voluntary labelling schemes are designed to 'inform consumers and thereby promote consumer products which are determined to be environmentally more friendly than other functionally and competitively similar products'.[43] Moreover, both mandatory and voluntary schemes – whether privately or state-administered – can be further distinguished into product-related approaches and NPR PPM-based labelling. This yields the following taxonomy:

(1) Mandatory government-administered labelling schemes based on product-related characteristics, including product-related PPMs.
(2) Mandatory government-administered labelling schemes – additionally or exclusively – based on NPR PPMs.
(3) Voluntary government-administered labelling schemes based on product-related characteristics, including product-related PPMs.
(4) Voluntary government-administered labelling schemes – additionally or exclusively – based on NPR PPMs.
(5) Privately sponsored labelling schemes based on product-related characteristics, including product-related PPMs.
(6) Privately sponsored labelling schemes – additionally or exclusively – based on NPR PPMs.

These labelling schemes raise partially divergent questions under WTO law.[44] The EU ecolabelling mechanism corresponds to type 4 of this taxonomy, given that it is preponderantly administered by public authorities, is voluntary in nature (i.e. market access is not de jure dependent on the fulfilment of the underlying labelling

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Dröge et al, National Climate Change Policy – Are the New German Energy Policy Initiatives in Conflict WTO Law?, German Institute for Economic Research discussion paper 374, 2003, pp. 13 et seq., available at http://econpapers.repec.org/paper/diwdiwwpp/dp242.htm (accessed 19 February 2010).

[42]See, e.g., Tietje, Voluntary Eco-Labelling programmes and Questions of State Responsibility in the WTO/GATT Legal System, JWT 29 (1995) 5, p. 123; Okubo, Environmental Labeling Programs and the GATT/WTO Regime, Georgetown International Environmental Law Review 11 (1999) 3, pp. 599 et seq. (605); Dröge et al, National Climate Change Policy – Are the New German Energy Policy Initiatives in Conflict WTO Law?, German Institute for Economic Research discussion paper 374 2003, pp. 13 et seq., available at http://econpapers.repec.org/paper/diwdiwwpp/dp242.htm (accessed 19 February 2010).

[43]See the OECD definition of voluntary labelling schemes in OECD, Environmental Labelling in OECD Countries, OECD Report 12, 1991.

[44]See Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 343 et seq. with further references.

criteria) and includes NPR PPM-based requirements owing to its life-cycle approach.

Applicability of the TBT Agreement, and of the GATT

Applicability of the TBT Agreement

The issue of whether voluntary, government-administered NPR PPM-based labelling schemes come under the TBT Agreement has been designated as one of the most debated questions in the discussions of the WTO Committee on Trade and the Environment.[45,46] Whereas the EU, Switzerland and Canada have expressed the view that such labels are covered by the TBT Agreement (and do not constitute per se violations of the agreement),[47] some developing WTO Members have been arguing that the negotiating history of the TBT Agreement shows that NPR PPM-based measures are not covered by the TBT Agreement, as its drafters had no intention of 'legitimizing' NPR PPM-based measures.[48] The view that such labelling schemes do not come under the purview of the TBT Agreement is also maintained in recent academic writings,[49] and is even regarded as the prevailing opinion.[50]

Regarding this contention, however, it has to be stressed that the relevant negotiating history of the TBT Agreement can be characterized as being ambiguous at best, and that systematic-teleological interpretation quite clearly leads to the conclusion that the TBT Agreement is applicable to NPR PPM-based measures in general and – by implication – to labels in particular.[51] The contrary stance taken by several writers

[45]Joshi, Are Eco-Labels Consistent with World Trade Organization Agreements?, JWT 38 (2004) 1, pp. 69 et seq. (80).

[46]The present section and the following section draw on Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 319 et seq. and 342 et seq.

[47]See EC, Labelling for Environmental Purposes. Submission by the European Communities under Paragraph 32(iii), WTO Doc WT/CTE/W/225, 6 March 2003, para. 28 (c), available at http://www.wto.org (accessed 19 February 2010); regarding Switzerland and Canada see Joshi, Are Eco-Labels Consistent with World Trade Organization Agreements?, JWT 38 (2004) 1, pp. 69 et seq. (pp. 80 et seq.).

[48]Joshi, Are Eco-Labels Consistent with World Trade Organization Agreements?, JWT 38 (2004) 1, pp. 69 et seq. (80 et seq.).

[49]See, e.g., Joshi, Are Eco-Labels Consistent with World Trade Organization Agreements?, JWT 38 (2004) 1, pp. 69 et seq. (80 et seq.); see also Puth, *WTO und Umwelt. Die Produkt-Prozess-Doktrin*, 2003, pp. 217-218; Tietje, Voluntary Eco-Labelling programmes and Questions of State Responsibility in the WTO/GATT Legal System, JWT 29 (1995) 5, pp. 123 et seq. (134).

[50]See Trüeb, *Umweltrecht in der WTO*, 2001, p. 453, who does not share this point of view however.

[51]Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 319 et seq. and 342 et seq.

and notably developing countries sometimes appears to be based on the misunderstanding that the non-applicability of the TBT Agreements would per se prohibit the introduction of NPR PPM-based requirements by other (developed) WTO members. The core of this possible misunderstanding seems to be rooted in the misconception that the TBT Agreement *permits* measures that otherwise would be prohibited. However, the TBT Agreement does not introduce permissions; rather, it lays down new obligations, i.e. disciplines that apply in addition to those of the GATT, in particular. Hence, its purported non-applicability would not imply that NPR PPM-based requirements would be per se prohibited (such measures may, however, come under the purview of the GATT[52]). Moreover, if one takes the view that the TBT Agreement imposes disciplines that tend to be *stricter* than those of the GATT, then (developing) countries that are troubled by the spectre of NPR PPM-based labelling schemes arguably should in fact advocate the TBT Agreement's applicability.

Additionally, it has to be noted that the TBT Committee decided in 1997 that the 'obligation to publish notices of draft standards containing *voluntary labelling requirements* under paragraph L of the [TBT Code of Conduct] is not dependent upon the kind of information provided on the label'.[53] Despite a pertinent disclaimer,[54] this decision can arguably be interpreted as an indication that there is some convergence of views at least that NPR PPM-based labels should not be regarded as being per se excluded from the scope of the TBT Agreement.[55]

Hence, if one takes the view that NPR PPM-based labelling schemes are not exempted from the scope of the TBT Agreement, then the EU ecolabelling mechanism, being voluntary in nature, must comply fully with the TBT Agreement and its Code of Good Practice in particular.

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[52]See the next subsection.

[53]See Committee on Technical Barriers to Trade, First Triennial Review of the Operation and Implementation of the Agreement on Technical Barriers to Trade, WTO Doc G/TBT/5, 19 November 1997, para. 12.

[54]The decision has been taken "without prejudice to the views of Members concerning the coverage and application of the Agreement", see Committee on Technical Barriers to Trade, First Triennial Review of the Operation and Implementation of the Agreement on Technical Barriers to Trade, WTO Doc G/TBT/5, 19 November 1997.

[55]Moreover, concerning the issue of justification of NPR PPM-based labelling schemes that may incur trade effects, the interpretative guidance ensuing from the 2002 World Summit on Sustainable Development (WSSD) conclusions should be taken into account, which explicitly call for voluntary "consumer information tools to provide information relating to sustainable production and consumption" (see para. 15(e) of the Implementation Plan of the 2002 World Summit on Sustainable Development (WSSD), available at http://www.un.org/esa/sustdev/documents/WSSD_POI_PD/English/POIToc.htm). Expressed in the words of the EU, "it is logical that WTO Members should continue to support in the WTO what they have called for at the WSSD (see EC, Labelling for Environmental Purposes. Submission by the European Communities under Paragraph 32(iii), WTO Doc WT/CTE/W/225, 6 March 2003, para. 13).

Applicability of the GATT

Since voluntary labelling schemes are meant to affect the competitive conditions among similar products, the question arises whether such mechanisms come under the purview of the GATT, which, pursuant to the General Interpretative Note to Annex 1A, applies beside the TBT Agreement to the extent there is no conflict between both agreements. This leads to the issue of the attribution of (partially) private conduct, which risks impinging on the order set up by GATT disciplines, to WTO Members.[56] Importantly, the same question would arise if a panel followed the stance, which was refuted in the preceding section, that the TBT Agreement does not apply to the EU scheme: this scheme would then be governed solely by the GATT. Both considerations constitute reasons why one should examine the applicability of the GATT to voluntary governmental labelling schemes.

As noted, if a product is considered eligible for the award of the EU label, the competent national body is to conclude a *contract* with the applicant, which covers its terms of use.[57] The 'competent body' may arguably be a governmental or a private body.[58] In either case, it must be independent,[59] so that the contract can be concluded between a *private* party, on the one hand, and an *independent* governmental or *private* body, on the other.

In such instances, it has repeatedly been questioned whether eventual distortions of competitive conditions can be attributed to the state. As this issue has already been dealt with in detail elsewhere,[60] it shall be recalled in the present context that several GATT panel reports have analysed this question.[61] Although these decisions were rendered under individual GATT provisions (namely Articles III:4, XI:1

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[56]See also Tietje, Voluntary Eco-Labelling programmes and Questions of State Responsibility in the WTO/GATT Legal System, JWT 29 (1995) 5, pp. 123 et seq.; Okubo, Environmental Labeling Programs and the GATT/WTO Regime, Georgetown International Environmental Law Review 11 (1999) 3, pp. 599 et seq.

[57]Article 9.1 of Regulation 1980/2000.

[58]See Article 4(1) ("body or bodies, within government ministries or outside").

[59]Article 4(2) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[60]See Vranes, The Single Euro Payments Area (SEPA) and its Compatibility with the GATS Disciplines on Financial Services, JWT 42 (2008) 3, pp. 508 et seq. (523 et seq.); Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 383 et seq. with further references.

[61]Panel Report, *Canada – Administration of the Foreign Investment Act*, L/5504, BISD 30S/140, adopted on 7 February 1984 *(Canada – FIRA)*, para. 5.4; Panel Report, *Japan – Restrictions on Imports of Certain Agricultural Products*, L/6253, adopted on 22 March 1988, para. 5.4.1.4.; Panel Report, *Japan – Trade in Semi-Conductors*, BISD 35S/116, adopted on 4 May 1988, paras. 106 et seq.; Panel Report, *EEC – Regulation on Imports of Parts and Components*, L/6657 – BISD 37S/132, adopted on 16 May 1990 (EEC – Parts and Components), para. 5.21; confirmed by the Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/R, adopted on 25 September 1997 (EC – Bananas III), paras. 7.179–7.180; Panel Report, *Japan – Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R, adopted 22 April 1998, para. 10.49.

and XXIII:1(b) of the GATT, respectively), the uniform and generalizable underlying theme is that under the GATT the conduct of private persons will be attributed to the state when they are sufficiently influenced through 'incentives and disincentives ... to act in [this] particular manner'.[62] This approach, which also interlocks with public international law guidelines and theoretical considerations in jurisprudence,[63] is teleologically justified by the fact that the GATT is concerned with non-discriminatory market access and competitive conditions in the internal market, which may also be influenced indirectly by the state through behaviour which appears not to emanate from it in form, but does so in substance.

It follows by implication that the EU environmental labelling scheme can be attributed to public authorities under the GATT, in view of the facts that the system as such has been established by EU legal acts,[64] that it is preponderantly administered by the EU and that the private bodies involved act, in large part, under mandates of the EU Commission and EU Member States.[65]

In sum, and this corrects a frequent misunderstanding,[66] the EU's voluntary ecolabelling scheme is neither exempted from nor prohibited per se under the disciplines of the TBT Agreement or the GATT solely owing to its reliance on life-cycle considerations. Hence, the scheme and existing and future implementing measures must be fully in compliance with the disciplines of these agreements.

Likeness

It is particularly disputed whether and how the fact that a regulatory measure is concerned with non-product-related production and processing measures affects the likeness analysis under central WTO trade in goods provisions such as Article III of

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[62] See also Panel Report, *Japan – Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R, adopted 22 April 1998, para. 10.49.

[63] Vranes, The Single Euro Payments Area (SEPA) and its Compatibility with the GATS Disciplines on Financial Services, JWT 42 (2008) 3, pp. 508 et seq. (523).

[64] See the analogy in the GATT Panel Report, *EEC – Restrictions on Imports of Apples from Chile*, L/5047, adopted 10 November 1980, BISD 27S/98, in which the panel held that detrimental effects could be attributed to a state if the pertinent regulatory system as a whole has been established by the state and its operation depended on the fine-tuning through administrative decisions and public financing (at para. 12.8).

[65] See pp. 211 et seq.

[66] See, e.g., Buck/Verheyen, *International Trade Law and Climate Change – a Positive Way Forward*, 2001, available at library.fes.de/pdf-files/stabsabteilung/01052.pdf (accessed 19 February 2010), p. 16 et passim ("eco-labelling schemes which take into consideration the non-product related environmental impacts of products might *per se* be prohibited under the TBT Agreement, although the legal analysis remains inconclusive") and Charnovitz, Trade and Climate: Potential Conflicts and Synergies, Pew Center Working Paper, 2003, p. 9, available at http://www.noconference.pewclimate.org/docUploads/Beyond_Kyoto_Trade.pdf (accessed 19 February 2010) with further references. Charnovitz himself does not share this view.

the GATT and analogous clauses in the TBT Agreement.[67] As noted, the fact that several authors take the view that physically similar products that differ only in their production or processing methods must be regarded as like products would – according to many writers – incur the consequence that they must always receive identical treatment. In other words, regulatory distinctions based on environmentally (un-)friendly NPR PPMs would be prohibited (subject to eventual justification under a clause such as Article XX of the GATT, unless one does take the view that even justification is impossible for process-based measures[68]). Therefore, the present section first analyses the notion of 'like products' in the GATT and the TBT Agreement on a general level. It then moves on to the specific nexus between likeness of products and NPR PPMs. In the last subsection, the results of this analysis are applied to the EU labelling scheme.

Likeness in the GATT and the TBT Agreement

This section first examines the meaning of 'like' and 'like products' in the GATT. It then turns to the interpretation of the similar wording of Article 2.1 of the TBT Agreement and the analogous provision of Article D of the Code of Good Practice (Annex 3 of the TBT Agreement), which applies to non-mandatory labelling requirements.[69]

Given that the terms 'like' and 'like products' are not explicitly defined in Article III:4 of the GATT (nor in Article III:2 first sentence of the GATT, Article 2 of the TBT Agreement or Article D of the Code of Good Practice, which will be analysed later), one has to turn to the context of these terms and the object and purpose of Article III, and eventually of the GATT and WTO law more generally.[70]

A close part of this context is Article III:1, according to which internal taxation and internal regulation 'should not be applied to imported or domestic products *so as to afford protection to domestic production*'. Article III:1 is not a norm that is applicable to a concrete case in itself, but constitutes an *interpretative principle* that is relevant for the interpretation of Article III as a whole,[71] as ensues from its

[67]This section is based on Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 191 et seq. and 323 et seq.

[68]See p. 208.

[69]See the TBT Agreement, Annex 1, Article 2.

[70]See Article 31 VCLT.

[71]A different approach was taken by the GATT Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992, BISD 39S/206, which, after having found the products at issue to be unlike, continued its examination of the measure at issue, asking whether this measure was applied to imported or domestic products "so as to afford protection to domestic production" (paras. 5.76–5.77). This move can only be explained if one considers Article III:1 as a *lex generalis* which is to be applied subsidiarily when no violation under Article III:2 or III:4 can be found. This approach could only be based on the view, just rejected, that Article III:1 is regarded as a norm which is in itself applicable to concrete cases. The view presented in the text above is also confirmed by WTO dispute settlement practice: see Appellate Body, *Japan – Taxes*

wording.[72] Being an interpretative principle, it is of special importance for construing the term 'like products' in Article III:4 (and Article III:2 for that matter).

Although the exact import of this clause is subject to intense debate in academic writing, there is consensus in general that Article III:1 makes it clear that the function of Article III as a whole is the avoidance of protectionism, a reading which is in line with the overall telos of WTO law.[73] Therefore, contextual as well as teleological arguments point to the importance of avoiding protectionism in favour of domestic products as the relevant background for interpreting the term 'like products'. Moreover, a regulatory intervention, in order to be protectionist in nature, requires that there be a competitive relationship between the domestic products protected and the disfavoured foreign products, since otherwise the protectionist effect would not normally be felt. Hence, Article III should be understood as being primarily concerned with products that are in such a *competitive relationship*.[74] Therefore, the term 'like products' should be interpreted as a term requiring an examination of the legally required intensity of the competitive relationship between domestic and foreign products.

This is further corroborated by the fact that Article III:2 second sentence, as clarified by the Note ad Article III, refers to 'directly competitive or substitutable' products: it follows from the two-sentence structure of Article III:2 and the wording

on Alcoholic Beverages, WT/DS8/AB/R, WT/DS9/AB/R, WT/DS10/AB/R, adopted on 1 November 1996 (Japan – Alcohol II), section H.2, in which the Appellate Body held that Article III:1 informs the rest of Article III, albeit in different form, depending on the individual provisions ("Article III:1 articulates a general principle that internal measures should not be applied so as to afford protection to domestic production. This general principle informs the rest of Article III. The purpose of Article III:1 is to establish this general principle as a *guide to understanding and interpreting* the specific obligations contained in Article III:2 and in the other paragraphs of Article III ...").

[72]See the text of Article III:1, pursuant to which "internal taxes and other internal charges, and laws, regulations and requirements ... *should* not be applied ... so as to afford protection"; see also Berrisch, Das Allgemeine Zoll- und Handelsabkommen, in: Prieß/Berrisch (eds.), *WTO-Handbuch*, 2003, p. 71, para. 32.

[73]See also Hudec, "Like Product": The Differences in Meaning in GATT Articles I and III, in: Cottier/Mavroidis (eds.), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law*, 2000, pp. 101 et seq (104–105); the fundamental purpose of avoiding protectionism and guaranteeing competition is also confirmed by the drafters of the GATT, see, e.g., the GATT Panel Report, *Italian Discrimination Against Imported Agricultural Machinery*, L/833, adopted 23 October 1958, BISD 7S/60, para. 13.

[74]See also Hudec, "Like Product": The Differences in Meaning in GATT Articles I and III, in: Cottier/Mavroidis (eds.), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law*, 2000, pp. 101 et seq. (103 et seq.); Appellate Body, *European Communities – Measures Affecting Asbestos and Products Containing Asbestos*, WT/DS135/AB/R, adopted on 5 April 2001 (EC – Asbestos), para. 117; Horn/Mavroidis, Still Hazy after all these Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination, EJIL 15 (2004) 1, pp. 61 et seq. have similarly argued with regard to tax discrimination that if consumers treat two products as unlike, then dissimilar taxation is unlikely to have considerable impact.

of Article III:2 second sentence[75] that this sentence is meant to function as a subsidiary clause which shields 'directly competitive or substitutable' (DCS) products from protectionist interventions. Hence, DCS products can be regarded as a broader category which *comprises* like products as a subgroup, in which the competitive relationship is even more evident.[76,77]

In sum, the context established by Article III:1 and Article III:2 second sentence as well as the telos of Articles III:2 and III:4 and the overall object and purpose of WTO law indicate that 'likeness' in Article III should be interpreted against the background of protectionism: 'like products' should primarily be understood to mean products that are in a *competitive relation* that is even *closer* than that of DCS products.

The decisive question is therefore that of when competition does exist between two products. It is obvious that competition inherently depends on *consumer perception*: even products that differ in their physical appearance and in respect of other criteria may be competitive if they are regarded as equivalent – that is as being interchangeable to a sufficient degree – by consumers; by the same token, products which appear quite similar with regard to criteria such as physical characteristics may theoretically be treated as dissimilar and non-competitive by consumers.

This focus on competition not only has the consequence of making the perspective of consumers central to the determination of likeness. Since *consumer* perception will normally be influenced above all by *product-related* criteria, it is a further corollary of this view that the relevance of the perspective that a regulator may have on the similarity of products finds no obvious confirmation in Articles III:2 and

[75]"*Moreover*, no contracting party shall *otherwise* apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principle set forth in paragraph 1." This clause has to be read in conjunction with the Note Ad Article III; otherwise it would appear to be inapplicable for lack of precision. See also Berrisch, Das Allgemeine Zoll- und Handelsabkommen, in: Prieß/Berrisch (eds.), *WTO-Handbuch*, 2003, p. 71, para. 57 with further references to jurisprudence.

[76]Thus, the Appellate Body regards like products as a "subset" of DCS products. Whereas DCS products are in direct competitive relationship, like products are "perfectly substitutable" according to the Appellate Body, see Appellate Body, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, adopted on 17 February 1999, para. 118.

[77]In a comparative law perspective, this consideration is also reflected in the jurisprudence of the European Court of Justice (ECJ) regarding Article 90 ECT, which contains an analogous two-tier structure that was precisely modelled after Article III:2 of the GATT: in its decisions, the ECJ appears to regard the standards of "likeness" and "directly competitive or substitutable" as different degrees on a common scale of decreasing competitive intensity. For a discussion of relevant ECJ case law see Demaret, The Non-Discrimination Principle and the Removal of Fiscal Barriers to Intra-Community Trade, in: Cottier/Mavroidis (eds.), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law*, 2000, pp. 171 et seq. (175 et seq); see also Stumpf, Commentary on Article 90 EC-Treaty, in: Schwarze (ed.), *EU-Kommentar*, 2000, p. 1144, para. 26; for an overview of relevant case law see, e.g., Waldhoff, Commentary on Article 90 EC Treaty, in: Calliess/Ruffert (eds.), *Kommentar zu EU-Vertrag und EG-Vertrag*, (2nd ed.) 2002, p. 1233, para. 18.

III:4. In other words, regulator-related interests should not normally be regarded as relevant in the determination of likeness.[78]

Similarly, it is not convincing that international environmental agreements should automatically be relevant in the determination of likeness,[79] since government interests, even if they are expressed in international agreements, cannot be regarded to be relevant per se in the likeness context as it is structured by the GATT.[80] A third consequence (to be examined in the next subsection) of the submission that the pertinent perspective in the determination of likeness is the perspective of consumers is that it appears possible that even *processing methods* which do not physically affect the product are regarded, by consumers, as rendering otherwise like products unlike.[81]

It is submitted that this interpretation of the term 'like products' clearly converges with pertinent GATT/WTO dispute settlement practice, which – in relying on the 1970 report of the *Working Party on Border Tax Adjustments* (BTA) – in particular refers to the following criteria in the determination of likeness: 'the product's *end-uses* in a given market; *consumers's tastes and habits*, which change from country to country; the *product's properties*, *nature* and *quality*'.[82] It can be argued that these criteria in general reflect the aforementioned focus on competition and consumer perspective.[83] The central importance of competition and the

[78]Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 200–215.

[79]This is submitted, e.g., by Fauchald, Flexibility and Predictability under the World Trade Organization's Non-Discrimination Clauses, JWT 37 (2003), pp. 443 et seq. (461).

[80]To avoid misunderstandings it must be stressed, however, that international agreements which subject trade in certain goods to specific disciplines may be regarded as establishing with particular evidence that underlying state interests are prima facie legitimate in the context of Article XX, and can be seen as well-established reasons for judicial deference in that respect. Moreover, if there is a conflict between such agreements and Articles III and XX of the GATT, these GATT norms may even become inapplicable. On this see Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 39 et seq., 69 et seq. and 358 et seq.

[81]See Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 323–324 for a detailed discussion of, and further references on, this particular issue.

[82]Report of the Working Party on Border Tax Adjustments, BISD 18S/97, para. 18. On the approach of GATT panels and the WTO Appellate Body see also Appellate Body, *Japan – Taxes on Alcoholic Beverages,* WT/DS8/AB/R, WT/DS9/AB/R, WT/DS10/AB/R, adopted on 1 November 1996 (Japan – Alcohol II), p. 22 with further references on jurisprudence; and Appellate Body, *European Communities – Measures Affecting Asbestos and Products Containing Asbestos,* WT/DS135/AB/R, adopted on 5 April 2001 (EC – Asbestos), paras. 88 et seq. with further references on jurisprudence in fn. 58.

[83]See also Fauchald, Flexibility and Predictability under the World Trade Organization's Non-Discrimination Clauses, JWT 37 (2003), pp. 443 et seq. (453); Trachtman, Lessons for the GATS from Existing WTO Rules on Domestic Regulation, in: Mattoo/Sauvé (eds.), *Domestic Regulation and Service Trade Liberalization*, 2003, pp. 57 et seq. (63–64). The criterion of physical characteristics of products can be considered as quite reliable indicators of substitutability (see also Hudec, "Like Product": The Differences in Meaning in GATT Articles I and III, in: Cottier/Mavroidis (eds.), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade*

inherently intertwined perspective of consumers have meanwhile also been explicitly highlighted in Appellate Body jurisprudence.[84]

Despite the emphasis on competition and consumer perspective, there remains a plurality of criteria in any given case, some of which may militate in favour of likeness, whereas others may indicate dissimilarity. Therefore, it seems appropriate that the Appellate Body has cautioned that the notion of likeness (possibly) varies, its scope depending on the applicable GATT non-discrimination provision, its context and the concrete case.[85]

This consideration is relevant also with respect to Article 2.1 of the TBT Agreement and Article D of the Code of Good Practice, where the term 'like products' is pivotal as well and where it remains undefined too. Just as in the GATT, one therefore has to examine the context and telos of this provision. It then quickly becomes clear that Article 2.1, Article D and the TBT Agreement more generally, like the GATT, are concerned with abolishing 'unnecessary obstacles to international trade'[86] and, hence, with ensuring international competition. This, and the fact that the TBT Agreement can be regarded as a concretization of the GATT, implies that the arguments which have just been presented with regard to the GATT apply within the TBT context as well. Therefore, in Article 2.1 of the TBT Agreement and the analogous provision of Article D of the Code of Good Practice as well, 'like products' should be understood to mean products that are in a close

Law, 2000, pp. 101 et seq. (103). Moreover, the BTA criteria may constitute important proxies for consumer perception if there are no relevant data available; similarly, end uses can be regarded as indicators of competition (see Horn/Mavroidis, Still Hazy After all These Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination, EJIL 15 (2004) 1, pp. 61 et seq. (63). More problematic, however, is judicial recourse to evidence from other markets, where consumer preferences may differ, as is emphasized by the Border Tax report itself (ibidem: "consumers' tastes and habits, which *change from country to country*"). Furthermore, the correlation between the criteria of tariff classification and tariff bindings, on the one hand, and the degree of competitive relation and consumer perspective, on the other, appears less direct.

[84]Appellate Body, *European Communities – Measures Affecting Asbestos and Products Containing Asbestos,* WT/DS135/AB/R, adopted on 5 April 2001 (EC – Asbestos), paras. 101 et seq. This approach has arguably been implicitly underlying most GATT/WTO decisions that have relied on the Border Tax report's set of criteria. This is also true of the decisions preceding the disputed "aim and effects" rulings in *US – Malt* (GATT Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992, BISD 39S/206) and in *US – Taxes on Automobiles* (GATT Panel Report, *United States - Taxes on Automobiles ("Gas Guzzler")*, DS31/R, 11 October 1994 (unadopted)): thus, the relevance of the perspective of consumers is emphasized in particular in the 1987 *Japan – Alcohol I* Panel Report, at para. 5.6 (Panel Report, *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages*, L/6216 - 34S/83, BISD 34S/83, adopted on 10 November 1987 (Japan – Alcohol I)); according to Horn/Mavroidis, Still Hazy after all these Years: The Interpretation of National Treatment in the GATT/WTO Case-law on Tax Discrimination, EJIL 15 (2004) 1, p. 61 as well, the perspective of consumers was central in panel decisions before this case.

[85]Appellate Body, *Japan – Taxes on Alcoholic Beverages,* WT/DS8/AB/R, WT/DS9/AB/R, WT/DS10/AB/R, adopted on 1 November 1996 (Japan – Alcohol II), chapter H.1.

[86]See Article 2.2. and the preamble of the TBT Agreement.

competitive relationship, a determination that has to be made primarily from the perspective of consumers.

Likeness and NPR PPM-Based Measures

It has been contended that the 'most logical conceptual basis' for a product–process doctrine, which distinguishes between regulation of products and NPR PPM-based measures, is the concept of 'likeness' in the 'like product' test of GATT Article III.[87] According to this view, by redefining the likeness concept, a panel could comply with its 'belief'[88] that 'the relevant community recognizes a normative obligation to limit a certain activity in a certain way'.[89]

This approach converges with views pursuant to which divergent PPMs cannot affect the likeness of otherwise similar products.[90] Such an approach to the concept of likeness is hardly defensible. The crux of the issue arguably lies in the fact that the terms 'product-related' and 'non-product-related' seem to imply a (quasi-) scientific approach: if traces of a given process or production method are not physically ascertainable in the final product, then the PPM in question is regarded as non-product-related.[91] This issue must, however, be distinguished from that of the likeness judgment, which is not exclusively concerned with the *physical* traceability of a given process or production method in the final product, but – as

[87]Hudec, The Product-Process Doctrine in GATT/WTO Jurisprudence, in: Bronckers/Quick (eds.), *New Directions in International Economic Law. Essays in Honour of John H. Jackson*, 2000, pp. 187 et seq. (198–200).

[88]Hudec, The Product-Process Doctrine in GATT/WTO Jurisprudence, in: Bronckers/Quick (eds.), *New Directions in International Economic Law. Essays in Honour of John H. Jackson*, 2000, pp. 187 et seq. (199).

[89]Hudec, The Product-Process Doctrine in GATT/WTO Jurisprudence, in: Bronckers/Quick (eds.), *New Directions in International Economic Law. Essays in Honour of John H. Jackson*, 2000, pp. 187 et seq. (199).

[90]See, e.g., GATT Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992, BISD 39S/206, para. 5.19; see also Panel Report, *United States — Standards for Reformulated and Conventional Gasoline*, WT/DS2/R, adopted on 20 May 1996 (US – Gasoline), para. 6.12; Joshi, Are Eco-Labels Consistent with World Trade Organization Agreements?, JWT 38 (2004) 1, pp. 69 et seq. (75 et seq., 79); Tietje, Voluntary Eco-Labelling programmes and Questions of State Responsibility in the WTO/GATT Legal System, JWT 29 (1995) 5, pp. 123 et seq. (139 et passim); and Okubo, Environmental Labeling Programs and the GATT/WTO Regime, Georgetown International Environmental Law Review 11 (1999) 3, pp. 599 et seq. (621 et passim).

[91]See, e.g., the definition provided by Canada in a communication to the CTE ("Non-product-related (npr) PPMs describe a process or production method which does not affect or change the nature, properties, or qualities of (nor discernible traits in or on) a product"; see Canada, Labelling and Requirements of the Agreement on Technical Barriers to Trade (TBT): Framework for informal, structured discussions, Communication from Canada, WTO Doc WT/CTE/W/229, 23 June 2003).

explained above – with the competitive relation that prevails between the products in question.

Given that the competitive relationship is inherently influenced by consumer perception,[92] it follows that PPMs which do not leave physical traces in the final product (and which are *not* product-'related' in any physically ascertainable way) may nonetheless be perceived, by consumers, as being 'related' to the product: if such PPMs are prone therefore to affect the competitive relation on the market, then this may constitute an indication that otherwise similar products may be unlike nonetheless.

This eventual indication of unlikeness must be balanced with other relevant indications militating in favour of likeness, however. It has rightly been emphasized in recent writings that a product's different production history may render it unlike other products,[93] even if this will be the exceptional case rather than the rule.[94]

Likeness and the EU Ecolabelling Scheme

The EU labelling scheme exemplifies well the risks of (inadvertent) discriminatory treatment of imported products that are inherent in the setting of labelling criteria. As noted, the ecolabel is awarded to those *products within a given product group* that fulfil the labelling criteria defined by the EU. Under the Community scheme, product group means 'a set of products that serve *similar purposes* and are *similar in terms of use*, or have *similar functional properties*, and are *similar in terms of consumer perception*'.[95] This definition largely overlaps with the definition of like products in the TBT Agreement and the GATT that was suggested above. Nonetheless, since the determination of likeness is a context-related value judgment, some products which may not be found to be 'like' in terms of WTO law may be included in the same product group under the EU labelling scheme. Inversely, products which are not included in a product group that is defined under the EU scheme may have to be considered under WTO law to be 'like' the products encompassed in the EU product group; hence, like products risk being excluded from having access to an ecolabel. This raises the risk of discrimination that will be discussed in the next subsection.

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[92]See pp. 217 et seq.

[93]Green, Climate Change, Regulatory Policy and the WTO. How Constraining Are Trade Rules?, JIEL 8 (2005), pp. 143 et seq. (160).

[94]See also Marceau/Trachtman, GATT, TBT and SPS: A Map of Domestic Regulation of Goods, in: Ortino/Petersmann (eds.), *The WTO Dispute Settlement System 1995-2003*, 2004, pp. 275 et seq. (322 et seq.); Schoenbaum, International Trade and Protection of the Environment: The Continuing Search for Reconciliation, AJIL 91 (1997), pp. 268 et seq. (p. 290); Quick/Lau, Environmentally Motivated Tax Distinctions and WTO Law – The European Commission's Green Paper on Integrated Product Policy in Light of "Like Product" and "PPM"-Debates, JIEL 6 (2003), p. 419.

[95]Article 3(1) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

Less Favourable Treatment

The EU ecolabelling regime does not introduce de jure discriminatory treatment, as it does not explicitly differentiate between products on the basis of their origin, given that the EU ecolabel can also be awarded, under the same conditions, to products originating outside the EU.[96] However, the fact that products that are not eligible, in terms of EU law, for the EU label may appear, in terms of WTO law, 'like' other products that are awarded the EU label incurs the risk of de facto discrimination under Article III:4 of the GATT and Article D of the Code of Good Practice (i.e. the aforementioned counterpart of Article 2.1 of the TBT Agreement), which applies to non-mandatory labelling requirements.

Since the notion of de facto discrimination is disputed in WTO law in general and as regards NPR PPM-based measures in particular, the next subsection addresses these issues. The second subsection then deals with the question of whether the EU ecolabelling scheme constitutes less favourable treatment in the sense of the GATT and the TBT Agreement.

PPM Requirements and the Concept of De Facto Discrimination

The product–process doctrine, pursuant to which regulation of products, on the one hand, and that of NPR PPM-based measures, on the other, are to be treated differently under WTO law, is also intricately intertwined with the so-called 'diagonal test' in determining the existence of de facto discrimination and the so-called aims and effects or regulatory purpose approach to likeness, which is a complement of the 'diagonal test'.[97]

The diagonal test'is a method that strives to determine whether regulatory treatment is de facto discriminatory. It does so by merely comparing a disadvantaged subgroup of foreign like products (subgroup 2 in the diagram) with that of the most favoured subgroup of domestic like products (subgroup 3 in the diagram), even if the latter subgroup consists of very few products.[98] Thereby, this test disregards whether there also exists a subgroup of foreign like products (subgroup 4 in the diagram) that receives treatment similar to that accorded to the most favoured domestic subgroup (subgroup 3 in the diagram). Therefore, the diagonal

[96]See Article 9(1) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[97]On this and the following see Ehring, De Facto Discrimination in World Trade Law. National and Most-Favoured-Nation Treatment – or Equal Treatment?, JWT 36 (2002), p. 921; and Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 223 et seq, 231 et passim.

[98]See Ehring, De Facto Discrimination in World Trade Law. National and Most-Favoured-Nation Treatment – or Equal Treatment?, JWT 36 (2002), p. 921, where a similar diagram is used.

test also disregards whether the proportions of the favoured and disfavoured subgroups are equal for domestic and imported products.

This is problematic, given that according to the traditional approach to discrimination a measure is de facto discriminatory if it produces a *disproportionate disparate impact* on foreign products,[99] a view which is confirmed by the object and purpose of Article III, i.e. the prevention of protectionism. According to this traditional view, one has to compare the treatment accorded to the two *entire groups* of like domestic products (comprising subgroups 1 and 3) and like foreign products (comprising subgroups 2 and 4), a method also applied, e.g., by the European Court of Justice (ECJ).[100] Thus, the ECJ inquires into whether imported products preponderantly fall into the disadvantaged group (subgroup 2) and whether domestic products preponderantly fall into the class of privileged products (subgroup 3).[101] More precisely, the ratio between domestic favoured and disfavoured products must be roughly equivalent to the ratio between foreign favoured and disfavoured products.[102] Meanwhile, this approach has arguably also been applied by the Appellate Body in its much discussed *EC – Asbestos* ruling.[103]

The aforementioned connection between PPM requirements and the diagonal test is shown, e.g., by a finding in the panel report in *US – Malt* (rendered under the largely analogous provision of Article III:2 of the GATT), which concerned tax

[99]See, e.g., Panel Report, *Japan – Measures Affecting Consumer Photographic Film and Paper,* WT/DS44/R, adopted 22 April 1998, para. 10.85, which defined de facto discrimination as "measures which have a *disparate impact* on imports" and clarified that "the complaining party is called upon to make a detailed showing of any claimed disproportionate impact on imports resulting from the origin-neutral measure"); incidentally, the USA as complainant also relied on this concept, see ibid; on this notion see also Hudec, GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test, in: Hudec (ed.), *Essays on the Nature of International Trade Law*, 1999, pp. 359 et seq. (360); Ortino, WTO Jurisprudence on De Jure and De Facto Discrimination, in: Ortino/Petersmann (eds.), *The WTO Dispute Settlement System 1995-2003*, 2004, pp. 217 et seq. (241 et seq.); see also the approach taken in EU law in the following text.

[100]On this see, e.g., Epiney, *Umgekehrte Diskriminierungen. Zulässigkeit und Grenzen der discrimination à rebours nach europäischem Gemeinschaftsrecht und nationalem Verfassungsrecht*, 1995, pp. 55 et seq.

[101]See, e.g., ECJ Case 112/84, *Humblot*, [1985] ECR 1367, para. 14; ECJ, Case 168/78, *Commission v. France*, [1980] ECR 347, para. 25; ECJ, Case 243/84, *John Walker*, [1986] ECR 875, para. 23; for references to recent ECJ case law see also Ehring, De Facto Discrimination in World Trade Law. National and Most-Favoured-Nation Treatment – or Equal Treatment?, JWT 36 (2002), pp. 921 et seq. (949).

[102]See Ehring, De Facto Discrimination in World Trade Law. National and Most-Favoured-Nation Treatment – or Equal Treatment?, JWT 36 (2002), pp. 921 et seq. (964 et seq.), referring also to the ECJ decision in Case C-167/97, *Seymour-Smith and Perez*, [1999] ECR I-623, paras. 63-64. In this case, the ECJ regarded ratios of 77.4:22.6 among men versus 68.9:31.1 among women as not constituting an inequivalence sufficient to be considered as discrimination.

[103]Appellate Body, *European Communities – Measures Affecting Asbestos and Products Containing Asbestos*, WT/DS135/AB/R, adopted on 5 April 2001 (EC – Asbestos), para. 100; for a detailed discussion see Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 238 et seq.

credits granted to small domestic breweries. In alluding to the product–process doctrine, this panel first ruled that production- or producer-related characteristics do not affect the nature of the product at issue. In its view, 'beer produced by large breweries is not unlike beer produced by small breweries'. It then went on to argue that 'even if Minnesota were to grant the tax credits on a non-discriminatory basis to small breweries inside and outside the United States, imported beer from large breweries would be 'subject ... to internal taxes ... in excess of those applied ... to like domestic products' from small breweries and there would still be an inconsistency with Article III:2, first sentence'.[104] This dictum constitutes an application of the 'diagonal test' to determining whether regulatory treatment is de facto discriminatory, which – as has just been explained – merely compares a disadvantaged subgroup of foreign like products (*in casu* beer produced by large foreign producers) with that of the most favoured subgroup of domestic like products (beer produced by small domestic producers). As has just been pointed out, this test overlooks that there may also exist a subgroup of foreign like products (*in casu* foreign like beer from foreign small producers) that receives treatment equivalent to that accorded to the most favoured domestic subgroup; and it overlooks that the proportions of the favoured and disfavoured subgroups may, in a given case, actually be equal for domestic and imported products. Put differently, the panel's approach disregards that it may be possible to draw distinctions in treatment between like products *even on the basis of production methods* that do not incur geographically disparate impacts on domestic and foreign products and do not, therefore, amount to de facto discriminatory treatment in terms of WTO law.

Furthermore, in this context, recent academic writings[105] appear to have overlooked that panel practice meanwhile has rightly found that process-based measures do not constitute a special case under the standard of differential treatment. Thus, in 2000, the *Canada – Automotive* panel rightly decided that a PPM-related import duty exemption 'cannot be held to be inconsistent with Article I:1 *simply* on the grounds that it is granted on conditions that are *not related to the imported products* themselves. Rather, we must determine whether these conditions amount to

[104] The relevant finding reads: "The Panel further noted that the parties disagreed as to whether or not the tax credits in Minnesota were available in the case of imported beer from small foreign breweries. The Panel considered that beer produced by large breweries is not unlike beer produced by small breweries. Indeed, the United States did not assert that the size of the breweries affected the nature of the beer produced or otherwise affected beer as a product. Therefore, in the view of the Panel, even if Minnesota were to grant the tax credits on a non-discriminatory basis to small breweries inside and outside the United States, imported beer from large breweries would be "subject ... to internal taxes ... in excess of those applied ... to like domestic products" from small breweries and there would still be an inconsistency with Article III:2, first sentence." See the GATT Panel Report, *United States – Measures Affecting Alcoholic and Malt Beverages*, DS23/R, adopted 19 June 1992, BISD 39S/206, para. 5.19 (emphasis added).

[105] An exception is Charnovitz, The law of environmental "PPMs" in the WTO: debunking the myth of illegality, Yale Journal of International Law 27 (2002) 1, pp. 59 et seq. (85).

discrimination between *like products* of different origins'.[106] The panel explained condemnations of process-based measures in earlier GATT practice,[107] some of which had in fact employed the formula 'not related to the product',[108] by pointing out that these cases had been concerned with discriminatory measures.[109]

Hence, the panel's reasoning *a contrario* confirms what has just been argued, namely that non-discriminatory NPR PPM requirements should be regarded as being consistent with non-discrimination disciplines of the GATT such as Article III:4 when they do not incur disparate impacts between foreign and domestic like products.[110] Although this decision has been rendered under Article I of the GATT, the panel's reasoning is clearly transposable to Article III as well. This view is also in conformity with academic writings according to which process-based measures should be regarded as being GATT-consistent if they do not constitute countrywide (i.e. directly discriminatory) measures.[111]

Less Favourable Treatment and the EU Ecolabelling Scheme

As explained above, under the EU ecolabelling scheme there is a risk that products that are not eligible, in terms of EU law, for the EU label, may appear, in terms of WTO law, 'like' other products that are awarded the EU label. Such geographically disparate impact – *if* it occurs – risks being compounded twofold. On the one hand, imported products which are new on a given national market often particularly depend on the use of marketing means such as labels for successful market penetration. On the other hand, the EU scheme envisages the promotion of labelled

[106] Panel Report, *Canada — Certain Measures Affecting the Automotive Industry*, WT/DS/142/R, adopted on 19 June 2000, para. 10.30 (emphasis added).

[107] See Panel Report, *Belgian Family Allowances* (*Allocations familiales*) (BISD 1S/59), para. 3, and the Panel Report, *Indonesia — Certain Measures Affecting the Automobile Industry*, WTO Doc WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, paras. 14.143 et seq.

[108] See Panel Report, *Indonesia — Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted on 23 July 1998, para. 14.143.

[109] Panel Report, *Canada — Certain Measures Affecting the Automotive Industry*, WT/DS/142/R, adopted on 19 June 2000, para. 10.25 et seq.

[110] It ensues from the panel's considerations that it also draws this conclusion itself. See, in particular, para. 10.40, where it states: "... we do not contest the validity of the proposition that Article I:1 does not prohibit the imposition of origin-neutral terms and conditions on importation that apply to *importers* ...".

[111] See Charnovitz, The law of environmental "PPMs" in the WTO: debunking the myth of illegality, Yale Journal of International Law 27 (2002) 1, pp. 59 (61, 67 et seq.); see also Howse/Regan, The Product/Process Distinction – An Illusory Basis for Disciplining 'Unilateralism' in Trade Policy, EJIL 11 (2000) 2, pp. 249 et seq. (252), who address this issue under Article III of the GATT. On this see also Petersmann, International Trade Law and International Environmental Law. Prevention and Settlement of International Environmental Disputes in GATT, JWT (1993), pp. 43 et seq. (68).

products and the labelling mechanism itself;[112] this, too, tends to reinforce the competitive disadvantages of products that are not covered by the scheme.

Hence, theoretically there is a risk of disparate impacts on like domestic and foreign products that amounts to de facto discrimination *if* foreign products turn out to be disproportionately affected by the EU scheme. Whether this theoretical risk materializes in practice depends on a factual analysis which is beyond the scope of this paper, as such an analysis would have to be conducted for any given product group individually. The important point to note, however, is the fact that NPR PPM-based regulations in general and NPR PPM-based labelling schemes in particular do not per se amount to de facto discriminatory treatment.[113]

Justification of NPR PPM-Based Labelling Schemes

There is also disagreement as to whether and under which conditions NPR PPM-based measures, in general, and process-based labelling schemes, in particular, can be justified under the GATT and the TBT Agreement. These issues are analysed in the next two subsections.

Justification and NPR PPM-Based Measures in General

A further variation of the product–process doctrine has been developed under Article XX, the general exceptions clause of the GATT. Especially, the two unadopted *Tuna* panel reports led to a widespread belief[114] that unilaterally imposed PPM requirements addressing extrajurisdictional[115] concerns are per se incapable of justification under Article XX. If this view were correct, it would be relevant for NPR PPM-based measures which, like the EU ecolabelling scheme,

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[112]Article 12 of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[113]This is arguably overlooked by Puth, *WTO und Umwelt. Die Produkt-Prozess-Doktrin*, 2003, pp. 251 et seq.

[114]This is also underlined by Howse, The Appellate Body Rulings in the Shrimp/Turtle Case: A New Legal Baseline for the Trade and Environment Debate, Columbia Journal of Environmental Law 27 (2002), pp. 491 et seq. (516), who argues that the Tuna/Dolphin reports, "although unadopted, ... embody a perspective almost universally held by the trade-insider network". See also Palmeter, Environment and Trade: Much Ado About Little?, JWT 27 (1993) 3, pp. 55 et seq. (66), and Mavroidis, Trade and Environment after the *Shrimps – Turtles* Litigation, JWT 34 (2000), pp. 73 et seq. (74), who speaks of a "long-standing erroneous interpretation". For a more elaborate analysis of the issues discussed in this and the following subsection see Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 256 et seq., 3277 and 342 et seq.

[115]The term "extrajurisdictional" is used in the GATT Panel Report, *United States – Restrictions on Imports of Tuna* (Tuna I), DS21/R, DS21/R, 3 September 1991, unadopted, BISD 39S/155, paras. 5.28 and 5.30 et seq.

also address transboundary and/or extrajurisdictional concerns and global commons such as the world climate.

In these reports, it was essentially held that such measures do not come under the ambit of Article XX, because otherwise a WTO member could 'unilaterally determine ... policies from which other contracting parties could not deviate without jeopardizing their rights under the General Agreement',[116] and because the NPR PPM requirements at issue were introduced 'so as to force other countries to change their policies with respect to persons and things within their own jurisdiction'.[117] Not least owing to the wide support for the *Tuna I and Tuna II* rulings by GATT contracting parties,[118] it was often held that process-based measures cannot be reconciled with Article XX, even though a subsequent, albeit unadopted, report again indicated that a process-based measure may, in principle, be justified under Article XX.[119]

This particular prong of the product–process doctrine is difficult to reconcile with international environmental law (in particular Principle 12 of the Rio Declaration, which was arguably adopted under the impression of the first *Tuna* ruling merely 9 months after its adoption,[120] and para 2.20 of Agenda 21), which has an undeniable bearing on the interpretation of Article XX.[121] These principles do not distinguish between product-related and process-based regulations. Moreover, unilateral trade measures concerned with transboundary and global concerns are not regarded as unjustifiable pursuant to these principles. Rather, such measures are 'merely' subjected to specific qualifications, in particular that they should be subordinated 'as far as possible' to cooperative efforts.

Although the Rio Declaration is not binding, its 'evidential value' regarding state intentions[122] is obvious, given that it has been adopted by 176 states,[123] and is considered as expressing worldwide consensus[124] and as constituting 'at present the most significant universally endorsed statement of general rights and obligations of

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[116]See GATT Panel Report, *United States – Restrictions on Imports of Tuna* (Tuna I), DS21/R, DS21/R, 3 September 1991, unadopted, BISD 39S/155, para. 5.27.

[117]See GATT Panel Report, *United States – Restrictions on Imports of Tuna* (Tuna II), DS29/R, 16 June 1994, unadopted, para. 5.25.

[118]This unadopted ruling has been reported to have received the unanimous support of all 39 GATT contracting parties that expressed an opinion, see Hudec, The Product-Process Doctrine in GATT/WTO Jurisprudence, in: Bronckers/Quick, (eds.), *New Directions in International Economic Law. Essays in Honour of John H. Jackson*, 2000, pp. 187 et seq. (189).

[119]See Panel Report, *United States – Taxes on Automobiles* ("*Gas Guzzler*"), DS31/R, 11 October 1994 (unadopted); see also Charnovitz, The law of environmental "PPMs" in the WTO: debunking the myth of illegality, Yale Journal of International Law 27 (2002) 1, pp. 59 et seq. (94).

[120]See Sands, "Unilateralism", Values and International Law, EJIL 11 (2000), pp. 291 et seq. (294).

[121]See the following text.

[122]See Birnie/Boyle, *International Law and the Environment*, (2nd ed.) 2002, pp. 82–84.

[123]See also Puth, *WTO und Umwelt. Die Produkt-Prozess-Doktrin*, 2003, p. 125.

[124]See Petersmann, International Trade Law and International Environmental Law. Prevention and Settlement of International Environmental Disputes in GATT, JWT (1993), pp. 43 et seq. (49–50).

states affecting the environment' which partly restates customary law and partly endorses new and developing principles of law.[125] The guidelines, which are derivable from the Rio Declaration and Agenda 21, are to a considerable extent mirrored in both *US – Shrimp* rulings of the Appellate Body, which has pointed out that PPM requirements are not a priori excluded from the scope of Article XX. Rather, in its words, 'conditioning access to a Member's domestic market on whether exporting Members comply with, or adopt, a policy or policies unilaterally prescribed by the importing Member may, to some degree, be a *common aspect* of measures falling within the scope of one or another of the exceptions (a) to (j) of Article XX'.[126] In the subsequent 2001 *Shrimp* proceedings under Article 21.5 of the Dispute Settlement Understanding (DSU), the Appellate Body reaffirmed that its ruling on the conditional justifiability of process-based measures constitutes a statement of principle.[127]

Justification of NPR PPM-Based Measures, and the EU Ecolabelling Scheme in Particular

Justification Under the GATT

There are three reasons why it seems appropriate to examine whether eventually discriminatory effects of a voluntary NPR PPM-based labelling regime such as the EU ecolabelling scheme can be justified under the GATT. First, as has been mentioned, the GATT applies beside the TBT Agreement to the extent that no conflict arises[128]; and it was shown above that the GATT in principle applies to

[125] See Birnie/Boyle, *International Law and the Environment*, (2nd ed.), 2002, pp. 82–84; for further arguments regarding the relevance of these principles for the interpretation of WTO law, see Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 329 et seq. with further references.

[126] Appellate Body, *United States – Import Prohibition of Certain Shrimp and Shrimp Products,* WT/DS58/AB/R, adopted on 6 November 1998, para. 121.

[127] Appellate Body, *United States – Import Prohibition on Certain Shrimp and Shrimp Products, Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted on 21 November 2001 (US – Shrimp II), para. 138; this is also pointed out by Howse, The Appellate Body Rulings in the Shrimp/Turtle Case: A New Legal Baseline for the Trade and Environment Debate, Columbia Journal of Environmental Law 27 (2002), pp. 491 et seq. (500–501).

[128] Regarding the relationship between the GATT and the TBT Agreement, there are two clear interpretative starting points. First, technical regulations are measures that are prone to affect trade in goods. To the extent this is the case, a technical regulation has to be regarded as a measure that falls under the scope of the GATT, in principle. Second, the existence of the general conflict clause in the General Interpretative Note to Annex 1A and the failure to address the question of the relationship between the GATT and the TBT Agreement more specifically in either agreement clearly points to the conclusion that both are meant to apply in parallel to the extent possible. To the extent of conflict, however, the provisions of the TBT Agreement do prevail (see the General Interpretative Note to Annex 1A). It follows that the respective scopes of application of the TBT Agreement and the GATT are not mutually exclusive, but overlap. This also corresponds to WTO jurisprudence, which has concluded more generally that the GATT is not entirely superseded by

voluntary NPR PPM-based labelling regimes such as the EU scheme, insofar as it can be attributed to the EU and its member states. Second, as indicated above, it is contested by some WTO members and several authors whether the TBT Agreement applies to NPR PPM-based labelling scheme at all. Although the present contribution does not share this view, a WTO panel might do so; it would then have to scrutinize a labelling scheme such as the EU regime under the GATT. Therefore, the following considerations on the eventual justifiability of such labelling mechanisms arguably also have practical value, besides their doctrinal import. Third, there is the problem that the TBT Agreement and its Code of Good Practice do not contain a general exception clause modelled after Article XX of the GATT. As will be argued below, one way of overcoming this problem consists in regarding Article XX of the GATT as an overarching exception clause that may become relevant, as a fallback clause, also under the TBT Agreement. This third reason explains why it seems useful to examine the possibility of justifying NPR PPM-based labelling schemes under the GATT *before* turning to the analogous issue under the TBT Agreement.

Under the GATT, Articles XX(b) and XX(g) are primarily relevant. Under Article XX(b), it has to be shown that a given measure is necessary to protect human, animal or plant life or health. It must also be shown, under the introductory clause ('chapeau') of Article XX, that the measure is not applied in a manner which constitutes a means of arbitrary or unjustifiable discrimination, or a disguised restriction on international trade. For reasons of space constraint, and given that the relevance of Article XX(g) and the chapeau standards for NPR PPM-based measures have already been treated elsewhere,[129] the following considerations concentrate on Article XX(b).

In view of the international efforts to combat climate change and the fact that, e.g., the United Framework Convention on Climate Change has quasi-universal membership,[130] it seems safe to assume that WTO panels would regard climate protection as a legitimate goal also within the terms of Article XX(b). However, the means adopted – *in casu* the EU ecolabelling scheme – must also be 'necessary' to protect this aim. This necessity test essentially inquires into whether there is an alternative measure, which is less trade restrictive than the regulatory measure

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other Annex 1A agreements, but only to the extent these agreements are inconsistent with the GATT (see Appellate Body, *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/AB/R, adopted on 20 March 1997, p. 14 ("The general interpretative note to Annex 1A was added to reflect that the other goods agreements in Annex 1A, in many ways, represent a substantial elaboration of the provisions of the GATT 1994, and to the extent that the provisions of the other goods agreements conflict with the provisions of the GATT 1994, the provisions of the other goods agreements prevail. This does not mean, however, that the other goods agreements in Annex 1A, such as the SCM Agreement, supersede the GATT 1994 ...")). For further details see Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 299 et seq.

[129]Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 327 et seq. with further references.

[130]United Nations Framework Convention on Climate Change (1992) 31 ILM 848.

actually adopted, and whether the WTO member in question could reasonably be expected to apply this alternative.[131] With the inception of the WTO, the WTO Appellate Body seems to have relaxed the necessity test when the values pursued are vital or particularly important.[132] Given that the protection of life and health, which is pursued through a means such as an ecolabelling scheme that also aims at the protection of the international climate, undoubtedly is a vital interest, the necessity threshold should in principle be lower in such a case.

However, the necessity test, as applied in WTO jurisprudence, also seems to contain considerations of suitability and effectiveness.[133] It is worth noting, therefore, that official EU documents state that the EU scheme (at least in its 1992 and 2000 versions) does not appear effective,[134] or, put differently, that it is questionable whether it is suitable for reaching its goal. Moreover, it has been held, on a more general level, that ecolabels are *typically* unsuitable means for environmental policy-making.[135]

In this respect, it must be stressed, however, that one can argue that the assessment of the suitability of a means adopted in pursuance of a legitimate goal should as a general rule employ a very low threshold for legal grounds and for interrelated reasons of decision-making theory,[136] and that this low degree of scrutiny is reflected also in WTO dispute settlement practice: thus, a measure is regarded, in standing Appellate Body jurisprudence, as suitable unless it 'cannot in any possible situation have any positive effect on conservation goals'.[137] Additionally, one must take into account that the effectiveness of labels may increase over time,[138] particularly when they are combined with further types of measures such as

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[131]This test, which was originally developed in WTO case law under Article XX(d) of the GATT, has been transposed also to Article XX(b), See Panel Report, *Thailand – Cigarettes*, paras. 74 et seq., and Panel Report, *United States — Standards for Reformulated and Conventional Gasoline,* WT/DS2/R, adopted on 20 May 1996 *(US – Gasoline)*, paras. 6.24 et seq.; for a detailed analysis of this test see, e.g., Neumann/Türk, Necessity revisited: Proportionality in World Trade Organisation law after Korea – Beef, EC – Asbestos and EC – Sardines, JWT 37 (2003), pp. 199 et seq. (207 et seq.); Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 268 et seq.

[132]See Appellate Body, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, adopted on 17 February 1999, para. 162: "The more vital or important those common interests or values are, the easier it would be to accept as "necessary" a measure designed as an enforcement instrument".

[133]See, e.g., Notaro, The New Generation Case Law on Trade and Environment, European Law Review 25 (2000), pp. 467 et seq. (486 with further references).

[134]EU Commission, Proposal for a Regulation of the European Parliament and of the Council on a Community Ecolabel scheme, COM(2008) 401 final, p. 4.

[135]Trüeb, *Umweltrecht in der WTO*, 2001, pp. 457, 459, 460.

[136]See Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 148–149 with further references.

[137]Appellate Body, *United States — Standards for Reformulated and Conventional Gasoline,* WT/DS2/AB/R, adopted on 20 May 1996 (*US – Gasoline*), p 21.

[138]ADAC, *Study on the effectiveness of Directive 1999/94 relating to the availability of consumer information on fuel economy and CO_2 emissions in respect of the marketing of new passenger cars. Final report*, 2005, pp. 61, 99 and 99 et seq.

label-related tax incentives and the promotion of the labelling scheme,[139] as has been quite clearly demonstrated by national experiences with the implementation of the EU's labelling scheme for cars[140] as well as by the EU-wide experience with the considerably more successful EU energy-efficiency labelling scheme.[141]

Justification Under the TBT Agreement

When one takes the (contested) view that NPR PPM-based labelling schemes come within the scope of the TBT Agreement,[142] then, as noted above, the EU labelling scheme, being a *voluntary* regime, would have to be scrutinized under the TBT Agreement's Code of Good Practice (Annex 3 of the TBT Agreement). Like the TBT Agreement in Articles 2.1 and 2.2, the Code of Good Practice contains two self-standing disciplines that are primarily relevant for an EU-type labelling mechanism: pursuant to Article D, such a mechanism must not be discriminatory; pursuant to Article E, even non-discriminatory measures must not create unnecessary obstacles to international trade.

Turning first to Article D, and assuming that the EU ecolabelling scheme were to give rise to de facto discriminatory effects, the problem arises that the Code of Good Practice and the TBT Agreement more generally do not contain an explicit exception clause (modelled after Article XX of the GATT) that relates to Article D. An analogous problem exists under the TBT Agreement, as the architecture of Articles D and E of the Code of Good Practice has a structural counterpart in the similar architecture of Articles 2.1 and 2.2 of the TBT Agreement.[143] Some writers

[139]EC Commission, Proposal for a Council Directive on passenger car related taxes, 5 July 2005, COM(2005) 261 final, at 6; see also ADAC, *Study on the effectiveness of Directive 1999/94 relating to the availability of consumer information on fuel economy and CO_2 emissions in respect of the marketing of new passenger cars. Final report*, 2005, pp. 99 et seq.

[140]See the study by ADAC, *Study on the effectiveness of Directive 1999/94 relating to the availability of consumer information on fuel economy and CO_2 emissions in respect of the marketing of new passenger cars. Final report*, 2005, pp. 54 and 104, which concludes that "[t]he fact that fiscal measures which are directly linked to the fuel consumption or CO2 emissions of passenger cars may have a great impact on consumers vehicle purchase decisions is clearly proven by the example of the Dutch BPM (registration tax) refund in 2002. From 01 January 2002, a fiscal incentive was introduced for environmental-friendly passenger cars of class A and B as a reduction from the registration tax (BPM). Buyers of passenger cars labelled "A" received an incentive of € 1,000, buyers of passenger cars labelled "B" € 500. In this year, the percentage of class A increased disproportionately from 0.3 % in 2001 to 3.2 %, class B from 9.5 % in 2001 to 16.1 %."

[141]Directive 92/75/EC (on this scheme see Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 375 et seq.); see also ADAC, *Study on the effectiveness of Directive 1999/94 relating to the availability of consumer information on fuel economy and CO_2 emissions in respect of the marketing of new passenger cars. Final report*, 2005, pp. 56 et seq. for a comparative assessment.

[142]See pp. 213 et seq.

[143]On this see Vranes, *Trade and the Environment. Fundamental Issues in International Law, WTO Law and Legal Theory*, 2009, pp. 305 et seq. with further references.

have doubted, therefore, whether it is possible at all to justify discriminatory measures under the TBT Agreement.[144] However, the preamble of the TBT Agreement underlines that justification that discriminatory measures must be possible also under this agreement, provided in particular that such measures are *necessary* and 'not applied in a manner that would constitute a means of *arbitrary or unjustifiable* discrimination...or a disguised restriction on international trade'. Moreover, there are several arguments that support the view that justification of measures found to violate Article D of the Code of Good Practice may be possible under principles similar to the GATT. First, it could be argued that all WTO provisions being cumulative in principle, Article XX of the GATT should, as an overarching provision, also be regarded as being applicable in respect of the TBT Agreement.[145] Second, one could argue that the possibility of justification provided in Article E is also applicable to infringements of Article D. Third, one could submit that the notion of discrimination under Article D is different from that of Articles I and III of the GATT: whereas, under the GATT, a measure which is found to be 'discriminatory' under Articles I or III can still be justified under Article XX, one could submit that a measure should only be regarded as 'discriminatory' for purposes of Article D if it amounts to unjustifiable discrimination.[146]

As mentioned before, Article E of the Code of Good Practice (just as Article 2.2 of the TBT Agreement) also constitutes a self-standing discipline that requires that even *non-discriminatory* measures do not represent unnecessary obstacles to international trade. Hence, even if labelling measures, adopted within the EU ecolabelling scheme for given product groups, were not to incur de facto discriminatory effects, they would have to be scrutinized under Article E as to their necessity. Moreover, the Code of Good Practice requires members to ensure that their standardizing bodies base their measures on appropriate and effective international

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[144]Schick, *Das Abkommen über technische Handelshemmnisse im Recht der WTO*, 2004, pp. 44 et seq.; Marceau/Trachtman, GATT, TBT and SPS: A Map of Domestic Regulation of Goods, in: Ortino/Petersmann (eds.), *The WTO Dispute Settlement System 1995-2003*, 2004, pp. 275 et seq. (285, 336–337); Tietje, Das Übereinkommen über technische Handelshemmnisse, in: Prieß/ Berrisch (eds.), *WTO-Handbuch*, 2003, p. 273, paras. 63–65. These writers focus on the structurally analogous architecture in Articles 2.1 and 2.2 of the TBT Agreement.

[145]See Marceau/Trachtman, GATT, TBT and SPS: A Map of Domestic Regulation of Goods, in: Ortino/Petersmann (eds.), *The WTO Dispute Settlement System 1995-2003*, 2004, pp. 275 et seq. (336–337).

[146]On the possibility of such terminology see also Kewenig, *Der Grundsatz der Nicht-Diskriminierung im Völkerrecht der internationalen Handelsbeziehungen. Band 1: Der Begriff der Diskriminierung*, 1972; Epiney, *Umgekehrte Diskriminierungen. Zulässigkeit und Grenzen der discrimination à rebours nach europäischem Gemeinschaftsrecht und nationalem Verfassungsrecht,* 1995, pp. 19–20; see also Schick, *Das Abkommen über technische Handelshemmnisse im Recht der WTO*, 2004, pp. 52–53 for a similar consideration under Article 2.1; however, Schick does not advocate the applicability of the principles of justification under Article 2.1, but concludes that Article 2.1 only applies to measures that pursue protectionist intentions. If the scope of application of Article 2.1 is reduced in this way, de facto discriminatory measures are rendered permissible under this permission, which shows that this restriction is inadequate.

standards,[147] and sets out transparency requirements similar to that relating to technical regulations under the TBT Agreement.[148] A complete assessment of the EU labelling scheme as to its consistency with these provisions would however require an examination of the large series of EU measures, in which individual labelling criteria for specific product groups have already been defined[149] or will be defined in future, and of the processes in which they are adopted. Nonetheless, it should be noted on a general level that labelling is commonly seen as a suitable and comparatively rather non-restrictive means for pursuing environmental goals[150]; that the EU scheme mandates public and private bodies involved in criteria-setting to take account of relevant international standards[151]; and that it aims to provide openness and transparency in the criteria-shaping process and in conformity assessment procedures.[152]

Mention should also be made of the view that the TBT Agreement's necessity test may require members to forgo state-administered voluntary labelling in favour of privately sponsored schemes.[153] However, this contention cannot stand unqualified, given that legitimate concerns may designate state-run schemes as more effective in the sense of the necessity test: thus, verification of compliance with labelling criteria may turn out to be more reliable in concrete cases, which may in turn lead to broader consumer acceptance and increased effectiveness of the label. Additionally, government involvement may be necessary to establish uniform labelling mechanisms that help avoid the consumer disorientation[154] which risks being incurred by an overly wide array of competing privately sponsored labels.

Finally, as regards the justification of EU-type discriminatory and non-discriminatory NPR PPM-based labelling schemes under the TBT Agreement, regard must also be had to Agenda 21, whose legal import on the interpretation of WTO law has

[147] Article F of the Code of Good Practice.

[148] Articles H and J of the Code of Good Practice.

[149] See subsection a.

[150] See, e.g., Green, Climate Change, Regulatory Policy and the WTO. How Constraining are Trade Rules?, JIEL 8 (2005), pp. 143 et seq. (186 with further references); Buck/Verheyen, *International Trade Law and Climate Change – a Positive Way Forward*, 2001, available at library.fes.de/pdf-files/stabsabteilung/01052.pdf (accessed 19 February 2010), p. 15.

[151] See Article 4(4) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[152] See Article 4(2) and Annex V(4)(b) of Regulation (EC) 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel, OJ 2010 L 27/1.

[153] See Canada, Labelling and Requirements of the TBT Agreement, WTO Doc WT/CTE/W/229, 23 June 2003, para. 9.

[154] On consumer confusion effects of multiple labels see WTO Secretariat, Information Relevant to the Consideration of the Market Access Effects of Eco-Labelling Schemes, WTO Doc WT/CTE/W/150, 29 June 2000, 2-3 with further references; the avoidance of confusion of consumers was also a reason for the EU introducing a mandatory EU-wide labelling scheme providing information on the consumption of energy by household appliances, see the preamble of Council Directive 92/75/EEC of 22 September 1992 on the indication by labelling and standard product information of the consumption of energy and other resources by household appliances, OJ 1992 L 297, p 16.

already been referred to,[155] and the Implementation Plan of the 2002 World Summit on Sustainable Development (WSSD). Although both emphasize the importance of ecolabelling as an instrument of environmental protection,[156] the WSSD Implementation Plan goes even further and explicitly endorses that countries should adopt NPR PPM-based labelling schemes that do not act as disguised trade barriers.[157]

Summary of Conclusions

This contribution has examined the new 2010 ecolabelling programme of the EU as a model test case, under WTO law, for voluntary government-administered labelling schemes that rely on NPR PPM-based criteria. With respect to this highly contested type of labelling scheme, this contribution has arrived at the following main conclusions:

- The EU ecolabelling scheme and similar voluntary NPR PPM-based labelling schemes are not exempted from the scope of the TBT Agreement, and must fully comply with the TBT Agreement and its Code of Good Practice in particular.
- This type of scheme is not per se prohibited under the TBT Agreement solely owing to its reliance on NPR PPM-based criteria.
- The EU ecolabelling scheme can be attributed, in terms of GATT law, to public authorities. It is neither exempted from nor a priori prohibited under the GATT solely owing to its process-based approach.
- The term 'like products' should primarily be understood to mean products that are in a close competitive relationship, a determination that has to be made primarily from the perspective of consumers.
- This approach to the determination of likeness is in line with GATT/WTO dispute settlement practice. In the determination of likeness, this practice has traditionally relied on the criteria developed by the Working Party on Border Tax Adjustment: these criteria can be regarded as indicators of a close competitive relation. The Appellate Body has recently confirmed this focus on a competitive relationship and the inherently intertwined perspective of consumers.
- It follows from the fact that the likeness determination is inherently influenced by consumer perception that divergent NPR PPMs can theoretically affect the likeness judgment, rendering otherwise similar products unlike in terms of WTO law.

[155]See pp. 229 et seq.

[156]See, e.g., paras. 4.21, 4.22, 9.12, 14.75, 19.4, 19.24, 19.26, 19.27, 19.28, 19.29, 19.44 and 19.49 of Agenda 21.

[157]See para. 15(e) of the Implementation Plan of the 2002 World Summit on Sustainable Development (WSSD), available at http://www.un.org/esa/sustdev/documents/WSSD_POI_PD/English/POIToc.htm (accessed 26 July 2006).

- Under labelling schemes, there is a clear risk that products which are not included in a product group that is awarded a label may have to be considered, under WTO law, to be 'like' the products that are entitled to such a label.
- Although this incurs a risk of (de facto) discrimination under labelling programmes such as the EU scheme, there is no per se violation of relevant non-discrimination disciplines in the GATT or the TBT Agreement.
- Put differently, non-discriminatory NPR PPM-based regulations in general and NPR PPM-based labelling schemes in particular should be regarded as being in conformity with relevant WTO non-discrimination disciplines if they do not incur disparate impacts between foreign and domestic like products.
- In its rulings which reflect relevant international environmental law, the Appellate Body has confirmed that NPR PPM-based regulations are not per se incapable of justification under Article XX of the GATT.
- NPR PPM-based labelling programmes of the EU-type are likewise capable of justification under Article XX of the GATT and under the TBT Agreement and its Code of Good Practice. WTO jurisprudence has recently applied a deferential standard of review when inquiring into the suitability and necessity of regulatory measures whenever vital interests such as human life and health are at stake. This approach is clearly relevant also when assessing climate-related measures such as the EU ecolabelling scheme.

Environmental Services and the General Agreement on Trade in Services (GATS): Legal Issues and Negotiating Stakes at the WTO

Mireille Cossy

Introduction

Environmental services is one of the salient topics in the services negotiations which are taking place in the World Trade Organization (WTO), under the aegis of the Doha Development Agenda (DDA). The importance attached to this sector contrasts with its quasi inexistence during the first multilateral negotiations on trade in services, which took place in the context of the Uruguay Round (1986–1994). Various reasons can explain the sharper profile acquired by this sector.

Since the beginning of the 1990s, environmental issues have steadily gained prominence on international and national agendas, and this has inevitably translated into new priorities in the WTO. Environmental services is also a sector where trading opportunities have expanded as a result of reform programmes implemented in key infrastructure utilities, such as waste and waste water: private companies have entered markets which, not so long ago, were the sole responsibility of public authorities. Increasingly stringent environmental regulation and growing awareness of environmental problems have also led to the creation of new products, both goods and services, beyond traditional infrastructure services. More recently, concerns related to climate change have also contributed to inject a new momentum in the environmental services negotiations.

Developed countries have been traditionally the main consumers, suppliers and exporters of environmental services. Economic development favours the enforcement of more stringent environmental standards which, in turn, triggers the need for new products; it also makes people more willing to pay for environmental protection. Developing countries are becoming important consumers of environmental services, due to a combination of factors including rapid industrialization and

Views and opinions expressed in this paper are personal and cannot be attributed to WTO Members or the WTO Secretariat.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_10, © Springer-Verlag Berlin Heidelberg 2011

urbanization, but also growing environmental awareness and increasing purchasing power. Firms specialized in environmental goods and services have emerged in some developing countries and have started to export their products, mainly on a regional basis.

This contribution will briefly recall the main characteristics of environmental services markets. It will explain the key features of the General Agreement on Trade in Services (GATS) and how they are relevant for this sector. Definition and classification have proved to be complex issues and we shall examine how environmental services are defined in the WTO and how Member governments use classification instruments. We shall also describe the type of GATS commitments undertaken by WTO Members in their national schedules. The last section will focus on the ongoing market access negotiations on environmental services: the Doha mandate on environmental goods and services, the negotiating process, the collective request on environmental services, offers of new commitments presented so far by Members and the EC-US proposal for an Environmental Goods and Services Agreement.

Main Characteristics of Environmental Services Markets

It is difficult to describe environmental services as a homogeneous sector because many different activities may have an environmental end-use. In the traditional sense, environmental services have referred to infrastructure services provided to the general public, such as water distribution, or collection and treatment of waste[1] and waste water. Infrastructure environmental services are prone to monopoly situations since they require special networks, involving high levels of investment; duplication of these networks often is economically and/or technically not possible. For a long time, government provision of these services was seen as essential to ensure reliable and affordable services (universal service) to the public. However, budgetary constraints, the need to resort to increasingly sophisticated technology and perceived inefficiencies affecting state monopoly management have led to the delegation of tasks to the private sector. The monopolistic characteristics of infrastructure services mean that there is no competition in the market; however, there may be competition for the market (through auctioning off concessions, for instance).

“Privatization” of environmental services (in practice, the term entails a range of different contractual forms between a public authority and a private firm, and does not necessarily involve full divestiture of assets) raises complex regulatory questions. It presupposes the existence of strong regulatory bodies, independent from

[1]Note that, in the WTO, cross-border trade in waste for the purpose of recycling is a goods issue, and, hence, falls under the GATT and other Annex IA agreements. Similarly, it is considered that recycling amounts to the production of goods, and not to the supply of a service. Consequently, recycling does not fall under the GATS.

political interferences, and able to develop and enforce adequate regulation. Privatization is also politically sensitive, as it concerns sectors with high visibility and important social and environmental implications. There is not one model when it comes to involving the private sector and restructuring often amounts to "choosing among imperfect systems": "Every restructuring and privatization programme must take explicit account of each sector's features (its underlying economic attributes and the technological conditions of its production) and the country's economic, institutional, social, and political characteristics".[2] Hence, the mixed record of privatization experiences. However, when the proper regulatory and supervisory framework is in place, involvement of the private sector may allow to attract investment, technology and expertise, and extend the service to unserved areas.

Besides public authorities, there is also a significant business-to-business market as industrial and commercial firms are important customers of those environmental services. In many countries, industries whose activities are particularly polluting (chemical producers, pharmaceutical companies, automotive industry, oil industry, electronic manufacturers, pulp and paper mills, steelmakers, etc) are subject to increasingly severe regulations regarding, *inter alia*, waste treatment and disposal, and waste water treatment. For example, the private sector accounted for about 40% of revenue generated by the US solid waste management services industry in 2001.[3]

Companies supplying infrastructure environmental services originate mainly from developed countries. For instance, in the water and sewage sectors, a few large European firms – Veolia (France), Agbar (Spain), Suez (France) and RWE (Germany) – are responsible for foreign investment. We find nearly the same firms in the waste sector – Onyx (a subsidiary of Veolia), Sita (a subsidiary of Suez), Waste Management Inc. (United States), Allied Waste (United States) and RWE Entsorgung. Developing country companies are fewer and smaller; they invest mainly in other developing countries and in least-developed countries.[4]

More recently, attention has turned to various activities, which may be defined as "non-infrastructural" environmental services in the sense that they are not provided to the public at large, but tend to be supplied from business to business. Hence, they do not raise the same social and political concerns as infrastructure services and, as they do not require huge capital investments, they offer market opportunities for small and medium-size firms. These services include, *inter alia*, air pollution services, restoring and cleaning up of soil and water, noise and vibration abatement, biodiversity and landscape protection.[5]

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[2]World Bank, *Reforming Infrastructure – Privatization, Regulation and Competition*, 2004, p. 42.

[3]United States International Trade Commission, *Solid and Hazardous Waste Services: An Examination of U.S. and Foreign Markets*, USITC Publication 3679, 2004.

[4]UNCTAD, *World Investment Report – Transnational Corporations and the Infrastructure Challenge*, 2008, pp. 112, 115; United States International Trade Commission, *Solid and Hazardous Waste Services: An Examination of U.S. and Foreign Markets*, USITC Publication 3679, 2004, p. I-4.

[5]For a more detailed description, see Geloso Grosso, *Regulatory Principles for Environmental Services and the General Agreement on Trade in Services*, Issue Paper No. 6, ICTSD, 2007.

The demand for environmental services is directly linked to public awareness of environmental problems and development of legislation. It also depends on the level of economic development. For instance, the level of cross-border trade and investment in solid and hazardous waste services is higher among developed countries where stringent regulation creates a demand for such services and encourages the development of waste management capacity.[6] The lack of adequate environmental services is a serious source of concern in developing countries, where "... insufficient provision of infrastructure and related services is one of the main obstacles to accelerating or maintaining the pace of development and to achieving the Millenium Development Goals (MDG) set by the United Nations in 2000."[7] In developing countries, more than 90% of sewage is discharged directly into rivers, lakes and coastal waters without any treatment. About half of the urban population lacks adequate waste disposal and less than 10% of urban wastes are treated.[8] Countries in Africa, Asia and Latin America together account for about 10% of the global environmental market, but are expected to register a strong growth rate, due to increasing stringent domestic regulations, enforcement of environmental standards and consumer pressures.[9]

The Application of the GATS to Environmental Services

The GATS entered into force in 1995 and represents the first multilateral framework for international trade in services. The GATS borrowed key principles from the General Agreement on Tariffs and Trade (GATT),[10] such as the principle of national treatment and the most-favoured-nation clause. But the specificities of services activities – in particular the fact that services are intangible and not storable – called for new concepts.

One of the most significant innovations found in the GATS is the introduction of four modes for defining the supply of services (Article I:2). All four modes are in principle relevant for environmental services, although their relevance may differ depending on the activity concerned. Cross-border supply (mode 1) covers the supply of services through telecommunications (internet, mail, etc.) or international

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[6]United States International Trade Commission, *Solid and Hazardous Waste Services: An Examination of U.S. and Foreign Markets*, USITC Publication 3679, 2004, p. 8–11.

[7]UNCTAD, *World Investment Report – Transnational Corporations and the Infrastructure Challenge*, 2008.

[8]Butkeviciene, *GATS Negotiations and Issues for Consideration in the Area of Environmental Services from a Development Perspective*, UNCTAD/UNEP, 2002.

[9]Sawhney/Chanda, *Trade in Environmental Services: Opportunities and Constraints*, WTO Research Paper Series No. 3, Indian Council for Research on International Economic Relation (ICRIER), 2004.

[10]The GATT, which entered into force in 1947, provides a framework for international trade in goods. It is now under the umbrella of the WTO Agreement.

transport; it has become increasingly important thanks to the development of electronic transactions. Mode 1 covers advisory and consulting services which can be provided through the internet in relation to environmental services. Moreover, technological progress has made it possible to remotely provide certain environmental services themselves, such as operation of wastewater treatment plants or control of air pollution levels from stationary sources (refinery, power generation plant, etc.). Consumption abroad (mode 2) refers to the consumer moving abroad to purchase a service, but it also covers situations where the property of the consumer "moves" or is situated abroad (repair of a ship, for instance). The relevance of mode 2 is more limited than that of other modes of supply, especially with respect to infrastructure environmental services sector. Establishment of a commercial presence (mode 3) covers the presence of juridical persons and other legal entities, such as corporations, joint ventures, partnerships, representative offices and branches. Mode 3 provides basic protection to investment made by services providers as it addresses restrictions affecting the number of service suppliers or limitations concerning foreign equity or types of legal entity. It is undoubtedly the most important mode of supply for environmental services, in particular with respect to infrastructures utilities where local presence is a prerequisite for supplying the service. Finally, the presence of natural persons (mode 4) covers the temporary movement of physical persons, whether employed of independent, going abroad to supply a service. Mode 4 commitments may contribute to increase the mobility of technicians and managers working for environmental services companies.

Mode of supply	Application in environmental services
Mode 1: cross-border supply	A company in country X monitors and controls air pollution levels in a power generation plant situated in country Y.
Mode 2: consumption abroad	A waste treatment plant in country X treats solid waste from country Y.
Mode 3: establishment of a commercial presence	A company from country X opens a subsidiary in country Y to supply soil and water remediation services.
Mode 4: presence of natural persons	A technician from country X works temporarily in a wastewater treatment plant subsidiary operating in country Y.

The GATS applies to all services, "except those provided in the exercise of governmental authority" (Article I:3(b)).[11] These, in turn, are defined as services which are supplied "neither on a commercial basis, nor in competition with one or more service suppliers" (Article I:3(c)). Activities falling under this carve-out are outside the scope of the Agreement, which means that they are subject to none of its disciplines and remain outside trade negotiations. Article I:3(b) is potentially relevant in the environmental services sector, in particular with respect to infrastructure services. However, the definition in Article 1:3(c) leaves a certain level of ambiguity as to its exact scope and only a case-by-base determination could allow

[11]With the only exception of the air transport sector which Members have explicitly excluded from the scope of the GATS.

to determine whether a service is provided "in the exercise of governmental authority".[12]

The main GATS obligations – market access and national treatment – are not generally applicable. They apply only in sectors in which a Member undertakes "specific commitments", which are listed in a national schedule. In GATS terms, the concept of market access is narrow: it entails six quota-type and other specified restrictions (Article XVI). National treatment refers to the obligation to accord to services and service suppliers of another Member treatment no less favourable than that it accords to its own like services and service suppliers (Article XVII). Specific commitments are minimum legal guarantees which govern access to a market and conditions of competition *vis-à-vis* domestic suppliers. In practice, market conditions can be – and, in fact, most often are – more liberal than what is recorded in GATS schedules.

Specific commitments may have a stronger impact on regulatory competence than tariff bindings do have in goods trade, but Members retain a great amount of flexibility when scheduling them. Members have the possibility to select the sectors and modes of supply for which they are ready to undertake specific commitments, and they may also qualify their commitments with various types of limitations, in order, for instance, to meet national policy objectives. Developing countries have the flexibility to bind fewer sectors, which means that there is a correlation between the level of development of Members and the number of sectors listed in their schedules: developed and least-developed countries have undertaken less commitments than developed countries.[13]

Under certain conditions, a Member can depart from its GATS obligations, for instance when measures are needed to protect public health or public morals (Article XIV). A Member may also modify or withdraw a specific commitment, but it will most likely have to offer compensation to affected trading partners by offering commitments in other sectors (Article XXI).

In the absence of specific commitments, the GATS imposes only limited obligations. The most significant of these is the most-favoured-nation (MFN) treatment, which is a prohibition to discriminate among foreign suppliers. The MFN obligation *per se* does not oblige to open a market to foreigners, but it obliges countries choosing to do so to treat all foreigners alike. Each Member had the opportunity to seek exemptions from the MFN obligation at the date of entry into force of the GATS (or at the time of its accession to the WTO). No specific MFN exemption has been taken in the environmental services sector, but 45 Members took horizontal MFN exemptions, which may affect environmental services as well. Most of these horizontal exemptions relate to the movement of natural persons supplying

[12]For more details on this issue, see Cossy, Water Services at the WTO, in: Weiss/Boisson de Chazournes/Bernasconi-Osterwalder (eds.), *Fresh Water and International Economic Law*, 2005.

[13]This is no longer true, however, for Members which have acceded to the WTO over the last 10 years and which have undertaken an overall – much – higher level of specific commitments than Members having negotiated their commitments during the Uruguay Round.

services, restrictions on land ownership, promotion and protection of investment and right of establishment of juridical persons.

WTO Classification and Definition of Environmental Services

The Services Sectoral Classification List and the UN Central Product Classification

Defining environmental services is not straightforward as the limits of the sector are less readily identifiable than those of other activities and countries have different conceptions as to what activities should be considered "environmental". Many services (engineering, architecture, construction, technical testing and analysis services, etc.) may have environmental, among other end-uses, and therefore are not regarded as environmental services *per se*.

Environmental services as commonly understood in the WTO are listed in the 1991 Services Sectoral Classification List,[14] which was developed during the Uruguay Round by the then GATT Secretariat with the objective of helping Members to establish their schedules of specific commitments. The W/120 is based on the 1991 United Nations Provisional Central Product Classification (hereinafter "CPC") and cross-refers to the sectoral definitions contained in the CPC. Neither the W/120 nor the CPC are compulsory instruments in the WTO, but Members are strongly encouraged to use them because the legal nature of services schedules requires the greatest possible degree of clarity in the description of sectors scheduled. Nevertheless, Members wishing to use their own classification system are free to do so, as long as they give a sufficiently detailed definition to avoid any ambiguity as to the scope of the commitment.[15] In practice, most Members have used a combination of the W/120 and the CPC.

It is important to stress that these classification instruments do not affect the scope of the GATS, which is determined by Article I:1: "[t]he Agreement applies to measures affecting trade in services". The term "services" includes "*any service in any sector* except services supplied in the exercise of governmental authority" (Article I:3(b), emphasis added). Hence, all services fall under the Agreement, irrespective of whether they are listed in the W/120 or the CPC. In the WTO, these two instruments are essentially tools which help Members to establish their schedules of commitments. They also tend to favour a certain homogeneity and facilitate comparison of commitments because – at least for those Members using them – all schedules speak a "common language".

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[14]*Services Sectoral Classification List*, Note by the Secretariat, MTN.GNG/W/120, 10 July 1991 (hereinafter "W/120").

[15]See *Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS)*, adopted by the Council for Trade in Services on 23 March 2001, S/L/92.

In the W/120, the environmental services sector is defined in Division 94 of the CPC, entitled "Sewage and refuse disposal, sanitation and other environmental protection services", and which includes: (i) sewage services (CPC 9401); (ii) refuse disposal services (CPC 9402); (iii) sanitation and similar services (CPC 9403); and "other" environmental services. The "other" category does not refer to any CPC item, but it is generally considered to include the remaining elements of the CPC environmental services category, i.e. cleaning of exhaust gases (CPC 9404), noise abatement services (CPC 9405), nature and landscape protection services (CPC 9406), and other environmental protection services not included elsewhere (CPC 9409).[16]

Moreover, it should be kept in mind that other activities, found in various sections of the W/120, are relevant for the provision of environmental services and for the protection of the environment more generally. These include, *inter alia*, research and development services on natural science (CPC 851); engineering design services for the construction of sewage, industrial and solid waste treatment plants (CPC 86724); integrated engineering and project management services for water supply and sanitation works turnkey projects (CPC 86732); testing and analysis services of chemical and biological properties of materials such as air, water, waste, soils (CPC 86761); construction services of water and sewer mains (CPC 5135).[17]

The focus that the environmental services section of the W/120 puts on infrastructure utilities has been criticized as being too narrow, outdated and not corresponding to today's reality of the environmental industry. In recent years, new activities have been developed as a consequence of increasingly demanding environmental regulations. These "non-infrastructural" services, such as air pollution control or environmental consulting, are becoming important, both from an environmental and economic point of view (see above).

It is against this background that, at the beginning of the new round of services negotiations, several Members proposed to revise the classification of the environmental services sector so as to better reflect the environment services industry.[18] In this context, the European Communities proposed a classification comprising seven sub-sectors based on the environmental media (air, water, soil, waste, noise, etc.), instead of the current four, which was intended to reflect the way services providers

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[16]See Appendix 1 for the complete CPC definitions of environmental services.

[17]The scattering of environment-related activities across various sectors is a consequence of the "slicing up" inherent to any classification system requiring that activities be listed in a mutually exclusive manner. The same problem arises in other sectors (telecommunications, transport, etc.). The perfect classification system remains an illusion. It seems indeed virtually impossible to design a detailed classification system capable of describing in details each major sector, without overlapping. "Classifying" services necessarily entails arbitrary decisions as to where to draw the line between various activities. The very concept of "major sector" results from an arbitrary choice.

[18]Written proposals on environmental services were tabled by the United States (S/CSS/W/25), the European Communities (S/CSS/W/38), Switzerland (S/CSS/W/76), Australia (S/CSS/W/112), Colombia (S/CSS/W/121), and Cuba (S/CSS/W/144).

tend to specialize: water for human use & wastewater management; solid/hazardous waste management; protection of ambient air and climate; remediation and cleanup of soil & water; noise & vibration abatement; protection of biodiversity and landscape; and other environmental & ancillary services. These sub-sectors would still be defined by reference to the 1991 CPC. The main, and most controversial, novelty in the EC proposal was the suggestion to include a reference to “water collection, purification and distribution” services in the W/120, as current classification instruments omit these activities. Several Members were strongly opposed to any kind of reference to water distribution services. This question appeared to be mainly a political issue because spelling out water distribution services in the W/120 would have no legal consequences on the scope of the GATS: all services, whether or not they are appear in the W/120, fall under the GATS, subject to the carve-out in Article I:3(b) (see above). Including an explicit reference to water distribution would not even oblige Members to undertake specific commitments in this sector; it may have at most an indirect impact on the negotiations insofar as governments tend to use classification instruments, in particular the W/120: hence, listing water distribution might facilitate requests and specific commitments.[19]

Other modifications proposed by the European Communities included: (i) the spelling out of various sub-sectors which are identified in the CPC, but not listed in the W/120, for instance, cleaning services of exhaust gases; noise abatement services; and nature and landscape protection services; (ii) the spelling out of activities, such as remediation and clean up of polluted soil and water, or services for the protection of biodiversity; (iii) the sub-sector “refuse disposal services” (CPC 9402) would explicitly include activities related to solid/hazardous waste management; (iv) activities, such as ecological research and consultancy, environmental impact assessment and biodiversity-related services are identified. These modifications were not really controversial since they mainly spell out existing CPC sub-categories. In the same proposal, the European Communities also put together a “checklist” of services which can have an environmental end-use; these include services in research and development, engineering, consulting, construction, distribution, and transport.

After several years of discussions, Members have not managed to agree on a formal revision/expansion of the W/120. Does it matter? Not really in practice. As explained above, classification instruments are tools to assist Members in scheduling their commitments, but do not have legal value *per se*[20] and do not determine the scope of the GATS. The fact that the GATS does not impose a classification system leaves Members free to use any classification they wish, such as that proposed by the EC. And this is what is actually happening in the current DDA

[19]On the issue of water services, see Cossy, Water Services at the WTO, in: Weiss/Boisson de Chazournes/Bernasconi-Osterwalder (eds.), *Fresh Water and International Economic Law*, 2005.

[20]However, whenever a Member includes, by cross-reference, a CPC definition into its schedule, it is bound by this definition.

negotiations (see below section on the "Collective request"). The extensive discussions which have taken place in the WTO Committee on Specific Commitments have allowed to identify the weaknesses of the W/120 as far as the environmental section was concerned and put in evidence missing activities. The consequences of the lack of results in the classification discussion should not be exaggerated: in practice, the absence of a an improved classification does not prevent Members from negotiating on a broader range of environmental services, including activities increasingly important in efforts to mitigate climate change. Contrary to what is claimed by some commentators, an agreed classification is not a prerequisite for market access negotiations under the GATS.[21] In various sectors, informal classification systems are developing as a consequence of Members' lack of consensus to formally revise the W/120 and are used in the negotiations. GATS schedules may become less homogeneous and less easily comparable in the future, but this is a secondary problem. What really matters is for each schedule to be internally coherent (in particular, overlapping between sectors must be avoided), and sufficiently clear and precise when it comes to defining the scope of the commitments. Insisting on the need for an "appropriate" classification as a pre-requisite for undertaking specific commitments only gives easy excuses to those wishing to avoid entering into negotiations.

There is one classification issue which would deserve further consideration, i.e. whether "new" activities can/should be considered to fall under existing CPC definitions – and what would be the consequences for specific commitments based on these definitions. To what extent can we include an activity which has developed, say, in the years 2000, under a 1991 definition? What is a "new" service as opposed to a new way of providing a service? These questions may arise with respect to various activities in the environment industry which has undergone significant technological development. Technologies being developed to curb CO_2 emissions in the context of climate change policies (for instance in the field of carbon capture and storage) may be a case in point.

"Environmental Services" and "Ecosystem Services"

Environmentalists use the concept of "environmental services" in a different context, i.e. when referring to the role played by ecosystems in mitigating climate change (forests acting as carbon sinks for CO_2, etc.) or providing other benefits to human beings. Ecosystems provide various "services" to human societies (some also refer to them as "ecosystem services"), including: provisioning services, such as food and water; regulating services, such as regulation of floods, drought, land

[21]See Nartova, Assessment of GATS's Impact on Climate Change Mitigation, in: Cottier/Nartova/Bigdeli (eds.), *International Trade Regulation and the Mitigation of Climate Change*, 2009.

degradation, and disease; supporting services such as soil formation and nutrient cycling; and cultural services such as recreational, spiritual, religious and other nonmaterial benefits.[22] The provider of these services is Mother Nature and human intervention is at best indirect (it may entail planting trees or preventing forest degradation, for example).

This homonymy seems to lead to some confusion. It has been suggested that "environmental services" provided by ecosystems might/should fall under trade rules[23] or that the WTO should ensure that developing countries be paid for the "carbon storage services" they provide to developed countries through their "comparative wealth of nature's services and capital".[24] While there is a legitimate question as to what extent and how one could promote "ecosystem services" and reward countries for maintaining ecosystems providing them, the GATS is not the right place to address these issues.

While the GATS does not define what a "service" is, it does define "trade in services" as the supply of a service through four different modes.[25] Pursuant to the GATS, service suppliers are either natural or legal persons.[26] It is also hard to see the meaning of market access and national treatment specific commitments in relation to ecosystem services. Similarly, what would the concept of "progressive liberalization", embodied in GATS Article XIX, from the point of view of countries "importing" ecosystem services? The GATS is a trade agreement which applies to economic activities resulting from human activities, but is not suited to deal with "services" provided by ecosystems. These questions must be addressed in appropriate forum (such as the carbon offsets under the Clean Development Mechanism (CDM) of the Kyoto Protocol). As noted by DG Lamy, it is not up to the WTO "to determine whether countries decide to trade environmental assets".[27] While "ecosystem services" do not fall under the GATS, (human) activities contributing to the protection and restoration of ecosystems do (such as, for instance, services related to reforestation, trading and brokering of emission allowances).

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[22]Hassan/Scholes/Ash (eds.), *Millennium Ecosystem Assessment, Ecosystems and Human Well-Being*, (Vol. 1), 2005, p. 27.

[23]"Whether or not climate-related and some other ecosystem services can be considered environmental services and potentially benefit from preferential treatment in trade is a question for the future", cit. Vikhlyaev, Environmental goods and services: Defining negotiations or negotiating definitions?, JWT 38 (2004) 1, pp. 93–122.

[24]See for instance, the Transcript of Internet chat with WTO Director-General Pascal Lamy, 18 October 2006, at http://www.wto.org/english/forums_e/chat_e/chat_transcript_oct06_e.doc.

[25]GATS Article I:1 and I:2.

[26]GATS Article XXVIII:(g) and (j).

[27]Transcript of Internet chat with WTO Director-General Pascal Lamy, 18 October 2006, at http://www.wto.org/english/forums_e/chat_e/chat_transcript_oct06_e.doc.

GATS Specific Commitments on Environmental Services

Existing Commitments

To date, 59 Members, at all levels of development, have undertaken specific commitments in at least one sub-sector of environmental services.[28] The number of commitments is virtually similar in the four sub-sectors listed in the W/120.[29] Thirty-eight Members have specific commitments across all four sub-sectors of the W/120. As compared to other sectors, such as tourism, financial services or telecommunications, GATS commitments on environmental services are limited.[30] This can be explained, in part, by the prevailing role played by public entities in providing infrastructure services which were the main focus during the Uruguay Round. Nevertheless, Members' policies may be more liberal in practice than what is reflected in GATS schedules.

Environmental services commitments on market access and national treatment follow a similar pattern across schedules and contain relatively few sectoral restrictions.[31] Thirty-one Members maintain mode 1 totally or partially "unbound"[32]; many of them consider that cross-border supply is not technically feasible for environmental services, especially infrastructure services; a few others limit cross-border commitments to advisory and consulting services. Mode 2 is generally fully bound, although the practical relevance of this mode is not clear for activities related to infrastructure environmental services; this, however, follows the trend observed in other sectors, where Members are reluctant to limit consumption abroad, presumably because they consider that they do not have jurisdiction over their own citizens abroad. Establishing a commercial presence is the most important mode of delivery for this sector and commitments under mode 3 are generally fully bound. Only eleven Members have listed sectoral market access and/or national treatment limitations on commercial presence, including: joint-venture requirements; foreign capital participation limitations; economic needs tests; and concession requirements. Mode 4 commitments follow the usual pattern found in most Members' schedules for all sectors: it is "unbound", except for certain categories of natural persons listed in the horizontal section of the schedule; these

[28]This count is based on the EC-12 schedule of commitments, which is the schedule still in force at the time of writing this contribution.

[29]The number of commitments is as follows: Sewage services (49); Refuse Disposal Services (48); Sanitation and Similar Services (49); Other (49). Hence, the total number of commitments amounts to 195. No Member has undertaken commitments on water distribution services.

[30]For instance, in the tourism sector, which also consists of 4 sub-sectors, 133 Members have commitments, for a total number of 327 commitments.

[31]Of course, limitations listed in the horizontal part of schedules apply to commitments in environmental services (such as restrictions on foreign equity, land ownership, subsidies, etc.).

[32]"Unbound" means that no commitment is undertaken for the mode of supply concerned.

are usually managerial positions, intra-corporate transferees or persons possessing some kind of specialized knowledge.

Some schedules limit the commitments to specific activities and, for that purpose, depart from CPC definitions. For instance: (i) China excludes "environmental quality monitoring and pollution source inspection"; (ii) Colombia has a commitment defined as "environmental conservation and industrial safety in connection with oil spills, pollution and fire"; (iii) some Members restrict their commitments – or part thereof – to advisory and consulting in relation to environmental services, which means that the actual supply of the service is not covered (Lesotho, South Africa, Chinese Taipei); (iv) Panama limits its commitments on cleaning of exhaust gases and noise abatement services to "implementation and installation of new or existing cleaning systems, remedial preventive and monitoring services; consulting services in these fields"; Panama's commitments on "nature and landscape services" are limited to "services for conducting studies on the relation between the environment and climate, including services of evaluation of natural disaster and reduction of their consequences".

The main restrictions scheduled in the environmental services sector relate to the respective roles of public and private entities. The purpose of these limitations is to exclude, or limit, access to services provided to the general public, and, thus, preserve the prevailing role of the public sector for the supply of these services. For instance, commitments undertaken by Estonia, Korea and the United States on sewage services and refuse disposal services are explicitly limited to services supplied to private industry, thus excluding services provided to the general public. Other Members (Liechtenstein, Norway, Sweden, Switzerland) achieve a similar objective by excluding "public service functions whether owned and operated or contracted out" by local, regional or central government.[33] Other schedules, while not excluding infrastructure services provided to the general public, reflect the primary role of the public sector in supplying these services. For example, Croatia indicates, with respect to the establishment of commercial presence, that sewage, refuse disposal and sanitation services "are legally considered as municipal activities, provided primarily by entities owned by local authorities. Private operators may be allowed to provide those services on the basis of a concession granted by local authorities." Another case in point is the horizontal limitation found in the schedule of the European Communities, which indicates that "[i]n all EC Member States services considered as public utilities at a national or local level may be subject to public monopolies or to exclusive rights granted to private operators."[34]

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[33]Incidentally, this contradicts the argument that the current W/120 classification "largely overlooks the provision of environmental services directly to industry". See OECD, *Environmental Goods and Services – The Benefits of Further Global Trade Liberalization*, 2001.

[34]In a footnote, the EC clarifies that "[p]ublic utilities exist in sectors such as related scientific and technical consulting services, R&D services on social sciences and humanities, technical testing and analysis services, environmental services, health services, transport services and services auxiliary to all modes of transport. Exclusive rights on such services are often granted to private operators, for instance operators with concessions from public authorities, subject to specific

One of the purposes of these limitations may be to try and remedy the lack of clarity of Article I:3(b) (see above), either by leaving public network outside the commitments, or by clarifying that market access may be subject to the obtaining of special rights (concessions, for instance). They also reflect the fact that the management of environmental services is often decentralized; local authorities retain the possibility to choose whether or not to involve a private supplier. These limitations leave a high level of discretion to the Member concerned and, consequently, imply only limited guarantees to foreign suppliers.

The Exclusion of Government Procurement

Pursuant to GATS Article XIII, government procurement of services is not subject to market access and national treatment commitments, nor to the MFN obligation.[35] This exclusion may have consequences in environmental services, in particular in infrastructure sectors, but also for other activities where state agencies are important customers, such as monitoring emissions of pollutants, or biodiversity and landscape protection services.

In practice, various forms of contractual relationships may be used between a public authority and a private operator. In infrastructure services, the sale of assets to a private company is uncommon. Governments prefer to retain the ownership of the facility and contract out certain tasks to a private company. So-called "public—private partnership" (PPP) make use of instruments, such as management, Build-Operate-Transfer (BOT) and concession contracts, the main difference being the degree of responsibilities delegated by a public authority and the financial arrangements agreed between the parties concerned. The question is whether some of these PPPs may qualify as government procurement, in which case they would fall outside the scope of specific commitments. Such a determination is uneasy because (i) there is no agreed definition of these various contractual forms, whose modalities may vary from one situation to another and mix the features of various contracts, and (ii) the definition in GATS Article XIII is broad (what is a governmental agency? When is a service purchased for "governmental purposes"? Etc). While some contractual forms of PPPs (such as management contracts and perhaps BOT in some cases) may fall under the GATS definition of government

service obligations. Given that public utilities often also exist at the sub-central level, detailed and exhaustive sector-specific scheduling is not practical" (GATS/SC/31).

[35]Article XIII:1 stipulates that: "Articles II, XVI and XVII shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the supply of services for commercial sale." Members have been negotiating on possible disciplines for government procurement of services for the last 15 years, but without success so far.

procurement,[36] concession contracts are likely to fall outside the definition of government procurement and thus be subject to GATS provisions.[37] Only a case-by-case determination will allow to determine whether a given contract falls under Article XIII.

These questions were raised in the WTO discussions on environmental services, but, unfortunately, never seriously discussed.[38] Moreover, there is no case-law which could shed light on them. Note, nevertheless, an interesting precedent in the schedule of Viet Nam, which joined the WTO in 2007. Viet Nam undertook additional commitments with respect to sewage services and refuse disposal services, stipulating that: “Foreign companies are allowed to do business activities in Viet Nam in the form of build-operate-transfer (BOT) and build-transfer-operate (BTO)”. The effect of this additional commitment is arguably to clarify that BOTs and BTOs are not regarded as government procurement and, thus, are subject to Vietnam’s commitments in environmental services.

Environmental Services in the Doha Development Agenda Negotiations

The Doha Mandate on Environmental Goods and Services

The negotiations on services started in 2000, as mandated in the so-called “incorporated agenda” contained in GATS Article XIX. In 2001, during the Doha Ministerial Meeting, it was agreed to launch a new round of trade negotiations, incorporating the services negotiations. On the same occasion, WTO Members also decided to negotiate on environmental goods and services as part of the trade and environment chapter of the Ministerial Declaration. Pursuant to the mandate contained in paragraph 31(iii) of the Declaration, Members agreed to negotiate, “with a view to enhancing the mutual supportiveness of trade and environment”, on

[36] They might nevertheless be subject to the disciplines of the plurilateral Agreement on Government Procurement (GPA) for those countries which have signed it. Several Members (Canada; European Communities; Hong Kong, China; Israel; Japan; Korea; Liechtenstein; Norway; Switzerland; and the United States) included sewage services in their list of services covered by the GPA. Except for Hong Kong, China, all of them have also undertaken specific commitments on sewage services under the GATS.

[37] For more details on the issue of government procurement and concessions, see Cossy, Water Services at the WTO, in: Weiss/Boisson de Chazournes/Bernasconi-Osterwalder (eds.), *Fresh Water and International Economic Law*, 2005.

[38] WTO, Council for Trade in Services, *Communication from Australia, The European Communities, Hong Kong China, Japan, New Zealand, The Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, and the United States*, Joint report on informal discussion on environmental services in the context of the DDA, TN/S/W/28, 11 February 2005.

"the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services".[39]

Promoting the liberalization of environmental goods and services is an area where the WTO can make a direct and immediate contribution to environmental policies, including those relating to climate change. In their final declaration following the Hokkaido Toyako Summit (Japan), G8 leaders recalled the importance of the WTO negotiations on environmental goods and services in relation to the fight against climate change: "Efforts in the WTO negotiations to eliminate tariffs and non-tariff barriers to environmental goods and services should be enhanced with a view to disseminating clean technology and skills. Additionally, consideration should be given to the reduction or elimination of trade barriers on a voluntary basis on goods and services directly linked to addressing climate change".[40] Reducing or eliminating barriers to environmental goods and services, can stimulate innovation, broaden product choice and lower prices. Provided an adequate regulatory framework is in place, GATS commitments on environmental services can help to create favourable conditions to attract investment and technology.

In practice, negotiations on environmental goods and services take place in two different bodies. While negotiations on environmental goods are conducted in the Special Session of the Committee on Trade and Environment (CTESS), environmental services are under discussion in the Special Session of the Council for Trade in Services (CTSSS), as part of the overall services negotiations. The negotiations on environmental services is slightly more advanced as it benefits from an existing – though perhaps imperfect classification – while Members are still struggling to agree on an adequate definition for environmental goods. The fact that the two issues are discussed separately, most of the time by different negotiators, may represent a disadvantage since, in practice, environmental goods and services are generally provided as a package. Nevertheless, the on-going debates show that Members are aware of the close linkages between goods and services in the environment industry.[41]

With respect to environmental services, the negotiations concentrated, in a first phase, on the identification and classification of those services (see above). The second phase is the so-called market access negotiation, which aims at broadening and deepening the scope of GATS commitments.

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[39]Ministerial Declaration, adopted on 14 November 2001, WT/MIN(01)/DEC/1.

[40]G8 Hokkaido Toyako Summit Leaders Declaration, 8 July 2008, para. 34, at http://www.g8summit.go.jp/eng/index.html.

[41]WTO, *Synthesis of Submissions on Environmental Goods*, Informal Note by the Secretariat, TN/TE/W/63, 17 November 2005.

The Market Access Negotiations on Environmental Services

The Collective Request on Environmental Services

In WTO market access negotiations, whether on goods or on services, the traditional method is the request-offer approach, whereby Members exchange bilateral "requests" in which they expose their expectations with respect to new market bindings by other Members. Offers are then circulated multilaterally, at agreed dates, and present the new commitments that Members are proposing to undertake at the conclusion of the negotiations; offers are negotiating documents and have no legal effect until they enter into force. In the services negotiations, Members also agreed to conduct request-offer negotiations on a plurilateral basis, in addition to the bilateral approach.[42] In the plurilateral process, a group of Members present a collective request to other Members in any specific sector or mode of supply, identifying their objectives for the negotiations in that sector or mode of supply.[43] In the absence of information regarding bilateral requests,[44] collective requests give a taste of what kind of new market opportunities are sought by Members. Of course, collective requests somehow reflect a lowest common denominator because they themselves result from a negotiating process between the requesting countries, whose interests may not entirely coincide. This is why it is understood that Members may still present bilateral requests to complement the collective request, if they consider that the latter does not fully take on board their export interests.

A collective request on environmental services was tabled in February 2006 by 9 "requesting" Members to 21 "recipients".[45] The request recalls that environmental goods and services were singled out for liberalization in paragraph 31(iii) of the Doha Declaration and notes that liberalized environmental services market "benefits both exporters and importers of these services as well as environment and development". It stresses that liberalization in these sectors does not impair the ability of governments "to impose performance and quality controls on environmental services and to otherwise ensure that service suppliers are fully qualified and carry out their tasks in an environmentally sound manner". It also recalls that WTO Members can establish and enforce the level of protection of their choice, *inter alia*, for consumers, health, safety, and the environment. Finally, the request notes the

[42]*Doha Work Programme*, Ministerial Declaration adopted at Hong Kong, December 2005, Annex C.

[43]The collective requests are available on the website of the European Services Forum (ESF), at http://www.esf.be/003/009.html.

[44]Bilateral requests are confidential documents, exchanged between the Members concerned. They are not notified to the WTO.

[45]The requesting Members are: Australia, Canada, EC, Japan, Korea, Norway, Switzerland, Chinese Taipei, and the United States. Moreover, requesting Members are also deemed to be recipients of this request. There is no official list of recipients, but we know that the request was not sent to any least-developed country.

close link between environmental services and other services, such as construction, engineering, technical testing and analysis, and management consulting.

Recipients are requested to undertake commitments across all environmental sub-sectors listed in the CPC. This means that, in addition to the three sub-sectors explicitly listed in the W/120 (CPC 9401 to 9403), Members are also asked to undertake specific commitments on the remaining CPC items (CPC 9404 to 9409), i.e. cleaning service of exhaust gases, noise abatement services, nature and landscape protection services, and "other" environmental protection services, which had remained de facto outside the Uruguay Round negotiations. The collective request explicitly states that it "does not address in any way water for human use (i.e. the collection, purification and distribution of natural water)". Concerning the classification system, the request leaves the choice between using the sub-headings contained in the W/120, or the revised headings used in classification proposals, such as the EC proposal discussed above, which is a way of endorsing *de facto* these proposals. However, irrespective of the choice of sub-headings, the request asks that CPC correspondences be "explicitly" listed.

The collective request also indicates the level of commitments which is expected for each mode. To date, many schedules have left mode 1 unbound, in part because Members have considered that this mode of supply was irrelevant for environmental services. For some time, however, several Members have been arguing that, due to technological developments, cross-border supply had become relevant for environmental services, in particular advisory and monitoring activities. Consequently, the request calls for full mode 1 commitments. Full commitments are also sought for mode 2, but without explaining the relevance of this mode. The request calls for "ambitious" commitments under mode 3 and specifically seeks the removal of restrictions such as foreign equity limitations or joint venture requirements. It also notes that environmental services may be subject to "public monopoly and exclusive rights" and stipulates that "to the extent that a Member awards exclusive rights contracts ..., foreign service suppliers should be able to participate in the supply of the service". This language aims at ensuring that commitments for this type of activity should, at a minimum, give foreign suppliers the right to compete for the market in cases where the number of suppliers is limited (concession contract for operating and maintaining a waste water treatment utility, for instance). The request on mode 4 is weaker than for the other modes since it is phrased as an "encouragement" rather than a firm request. This cautious approach reflects the fact that several Members having export interests in environmental services are on the defensive side when it comes to undertaking further mode 4 commitments.

It is not possible to assess the impact of the request on offers because a few months after the collective request was tabled, the DDA negotiations stalled, and with them the services negotiations. Hence, all the conditional offers tabled so far are based on the bilateral request/offer negotiations (see following section). Nevertheless, plurilateral discussions which took place between requesting Members and recipients seem to indicate that the latter have limited flexibility to undertake meaningful new commitments on environmental services. In December 2007, the European Communities reported to the Council for Trade in Services Special

Session that, while only half of the recipients had either existing commitments or offers in the environmental services sectors, "the possible improvements outlined by some recipients were usually very limited in their scope."[46] "Signals" given by the 31 Members which participated in the July 2008 Services Signalling Conference were only slightly more encouraging.[47]

Conditional Offers

So far, 16 Members have offered to make new commitments on environmental services. These offers vary greatly in terms of sectoral coverage, but also with respect to the degree of market access and national treatment envisaged. No Member is proposing to undertake specific commitments on water distribution.

In the offers, various countries limit the types of activities covered by the commitments in order to exclude or reduce access to public networks. For instance, some exclude public work functions altogether and others require partnership with local authorities. Members' appreciation as to the relevance and/or feasibility of modes 1 and 2 for infrastructure environmental services continues to diverge. Overall, offers follow the pattern of existing commitments, the only difference being that relatively more Members take limitations with respect to public networks.

Some Members (including the EC), which already have commitments on environmental services, propose to redefine their sectoral entries along the lines of classification proposals discussed in the first phase of the negotiations, such as the one presented by the European Communities. Most proponents present this as a technical change, which would not alter the scope of the commitment. However, there is no complete agreement among WTO Members on the question whether modifying the headings of the sub-sectors, while maintaining references to the CPC, might modify the scope of the commitments concerned.

Overall, the level of offers proposed in environmental services is low. It is difficult, however, to determine to what extent this disappointing result is owed to factors affecting the services negotiations in general – if not the DDA as a whole – or whether characteristics of environmental services markets explain the lack of

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[46]WTO, Council for Trade in Services Special Session, *Report of the Meeting Held on 15 November and 6 December 2007*, Note by the Secretariat, TN/S/M/28, 5 May 2008.

[47]The report of the Conference indicates that "[m]any indications of improvements were given across the range of environmental services, including: sewage services; sanitation services; refuse and solid waste disposal services; waste water management services; soil remediation and clean-up; environmental laboratory services; and other services related to air pollution control and noise abatement. In addition to expanding sectoral coverage, several participants were willing to expand the modal scope of their commitments, and to reduce or eliminate restrictions such as joint venture requirements and foreign equity limitations. Several participants expressed aspirations for new commitments on all modes of supply across the range of environmental services. A specific request was made for commitments on advisory services under mode 1." WTO, *Services Signalling Conference*, Report by the Chairman of the TNC, JOB(08)/93, 30 July 2008, available at http://docsonline.wto.org/DDFDocuments/t/jobs/ext08/93.doc.

readiness to bind access levels under the GATS. Probably a mix of the two. As noted by the Chairman of the Services negotiating group, it is "widely acknowledged that the overall quality of initial and revised offers is unsatisfactory" as "[f]ew, if any, new commercial opportunities would ensue for service suppliers]".[48] In addition, some characteristics specific to the environmental services sector – role of public authorities in providing infrastructure services, lack of environmental legislation and, hence, of incentives to upgrade standards – may compound the lack of progress.[49]

The EC-US Proposal for the Negotiation of an Environmental Goods and Services Agreement

In December 2007, in the run-up to the UN Climate Change Conference in Bali, the European Communities and the United States presented in the WTO a joint proposal that aimed at giving a new momentum to the negotiations on environmental goods and services mandated in paragraph 31(iii) of the Doha Declaration. This ambitious proposal focuses on climate change-related goods and services, and is based on a two-tier approach.

With respect to services, the proponents ask that, under tier one, WTO Members "involved in the plurilateral negotiations"[50] should take commitments in services that can contribute to efforts to address climate change. The proposal highlights activities where GATS commitments should be undertaken, such as environmental services (air pollution and climate control services); technical testing and analysis (air composition and purity testing services); energy-related services (e.g. engineering and maintenance services to optimise the environmental performance of energy facilities); and services for the design and construction of energy-efficient buildings and facilities. Under tier two, WTO Members "subject to formula cuts in NAMA, as well as other interested Members",[51] would negotiate an Environmental Goods and Services Agreement (EGSA), which would go beyond climate change-related products and consider environmental protection more generally. With respect to

[48]WTO, Council for Trade in Services Special Session, *Report by the Chairman to the Trade Negotiations Committee*, TN/S/20, 11 July 2005.

[49]See also Adlung, GATS' Commitments on Environmental Services: 'Hover Through the Fog and Filthy Air'?, in: Cottier/Nartova/Bigdeli (eds.), *International Trade Regulation and the Mitigation of Climate Change*, 2009.

[50]The expression "Members involved in the plurilateral services negotiations" presumably refers to the 9 Members which have signed the plurilateral request on environmental services in March 2006 and the 21 Members to which this request was sent. It is somehow regrettable that the proposal limits its ambitions to some 30 Members from the start.

[51]WTO Members subject to formula cuts in the non-agriculture market access negotiations include all Members, except least-developed countries, and so-called small- and vulnerable economies (SVEs). Hence, tier two concerns a broader membership than tier one.

services, Members would be expected to bind existing market access and national treatment, and undertake new liberalization with respect to a broad set of environmental and climate-related services, including environmental, energy, construction, architectural, engineering and integrated engineering services.[52] The European Communities and the United States take the WTO Information Technology Agreement[53] (ITA) as a model and propose that the EGSA should be a free-standing agreement, applying on an MFN basis.

The EC-US proposal entails a significant expansion of the concept of "environmental services". In addition to environmental services *stricto sensu* (i.e. as defined in the W/120 Services Classification List), it identifies other sectors as being relevant for implementing environmental protection objectives, including climate change, in particular energy, architecture and engineering and construction services. This contrasts with the reading of the scope of paragraph 31(iii) prevailing so far, whereby environmental services were understood as being those defined as such in the W/120 Services Classification List. From a technical point of view, the definition of environmental services may be uneasy, should one decide to go beyond the environmental services sector as currently defined in the W/120.

The second-tier, i.e. the negotiation of an EGSA, calls for a binding of the status quo and further liberalization in services which can benefit the environment. We should note, in this regard, that the mere consolidation of existing levels of market access and national treatment commitments would already represent a significant progress. It is widely acknowledged that GATS schedules are far from reflecting current levels of access in most sectors. Services markets are in reality more open than what Members have bound in their schedules and consolidating current levels of access through GATS commitments would foster greater transparency and predictability for suppliers. However, references to the desirability of binding current levels of access were made in the past in the services negotiations and met each time with strong resistance. The EC-US proposal received a lukewarm reception in both the CTESS and the CTSSS. While several developed countries supported its objectives, developing countries were critical: they viewed it as "premature", going beyond the Doha mandate and criticized it for primarily

[52]See Summary of U.S. and EC Proposal for Liberalizing Trade in Environmental Goods and Services in the WTO DDA Negotiations, at http://trade.ec.europa.eu/doclib/docs/2007/november/tradoc_136955.pdf.

[53]The Ministerial Declaration on Trade in Information Technology Products (ITA) was concluded at the Singapore Ministerial Meeting, in December 1996, by 29 Members. The number of participants has grown to 70, representing about 97 per cent of world trade in IT products. The ITA provides for participants to completely eliminate tariffs and other duties on all IT products covered by the Agreement. Developing countries have been granted extended periods for some products. Commitments undertaken under the ITA are on an MFN basis, and, thus, benefit to all WTO Member. For more information, see http://www.wto.org/english/tratop_e/inftec_e/itaintro_e.htm.

favouring developed country export interests.[54] Since the proposal was tabled, there have been few indications as to whether and how the proponents intended to pursue the matter.[55] It must be acknowledged that, in the context of a comatose DDA, the ambitions expressed in the proposal (broad range of goods and services, binding status quo and undertaking further liberalization) may have sounded somewhat provocative to some countries.

Leaving aside its technical weaknesses, the EC-US proposal has the merit of initiating a potentially interesting avenue for increasing the synergies between trade and environment policies, i.e. a separate, self-standing agreement aiming at facilitating the liberalization of goods and services which benefit the environment. The WTO structure is flexible enough to allow for sectoral initiatives, as evidenced by the ITA, the special rules on compulsory licensing under the TRIPs Agreement to address the problem of access to essential drugs, the on-going negotiations on fishery subsidies, etc. Hence, assuming that there is the necessary political momentum, nothing would prevent Members from negotiating on the basis of environmental considerations with the objective of facilitating trade in products and services benefiting the environment.

This approach has already been proposed by some commentators. For instance, two authors have suggested an Environmental Area Initiative approach, whereby WTO Members would organise negotiations against the background of environmental considerations (such as targeted reduction of greenhouse gases; supply of clean water and waste water treatment; solid waste management; promotion of renewable energies and fuel efficiency; promotion of extensively produced agricultural goods). Negotiations could cover tariffs, non-tariff measures, services, technical cooperation and could also include other regulatory areas, such as intellectual property. The authors consider that one of the main preparatory steps for such a negotiation would be to address definitions and classification of environmental goods and services, and establish linkages between them.[56]

Conclusion

The public function of environmental services and the predominant role played by public authorities have meant that, until recently, there was limited scope for private operators and the sector was not really export-oriented. As a consequence, environmental services is one of the sectors which records the lowest level of

[54]See Council for Trade in Services Special Session, *Report of the Meeting Held on 15 November and 6 December 2007*, Note by the Secretariat, paras. 279–308.

[55]Peter Mandelson, then EU Trade Commissioner, made a reference to the EGSA in October 2008. See *Le commerce international au secours de l'environnement*, Les Échos, 3 October 2008.

[56]Cottier/Baracol-Pinhão, Environmental Goods and Services: The Environmental Area Initiative Approach and Climate Change, in: Cotter/Nartova/Bigdeli (eds.), *International Trade Regulation and the Mitigation of Climate Change*, 2009.

specific commitments under the GATS. Increasing role for the private sector in activities traditionally carried out by public entities, more stringent environmental regulation and consumers' awareness triggering demand for new products have contributed to create new market opportunities for service suppliers. Consequently, this sector is the object of a renewed interest in the WTO negotiations.

Demographic growth, rapid industrialization and urbanization are creating significant needs for the deployment of environment technology. Basic infrastructure – water supply and sewage, waste treatment – still lags behind in many developing countries, causing serious public health problems, and slowing down social and economic development. As put by UNCTAD, "[o]ne way of addressing the shortfalls in infrastructure and related services in developing countries is to mobilize FDI and other forms of TNC participation to supplement and complement the activities of domestic public and private infrastructure enterprises."[57] The GATS can play a limited but useful role in complementing and supporting policy decisions taken in capitals and in relevant international institutions. By providing a predictable legal framework, it can contribute to sending positive signals to investors, fostering FDI, and facilitating the transfer of technology and know-how.

During the initial phase of the negotiations on environmental services, work focused on definition and classification issues, with the objective of updating existing instruments in order to better reflect the commercial reality of the industry. While this work has not resulted in a formal revision of existing instruments, it has allowed trade officials to better understand the environment industry. Moreover, some Members have autonomously proposed to use new classifications in their DDA offers, which shows that the lack of an agreed classification is not an obstacle to the negotiation of improved commitments. So far, market access negotiations on environmental services have not translated into meaningful offers of new GATS commitments. This is due in part to some characteristics of environmental services – active role of public authorities in providing certain services, political sensitivity and lack of environmental standards. Moreover, the services negotiations cannot be dissociated from the DDA package and are therefore affected by blockages and delays occurring in other areas of the negotiations (in particular agriculture and industrial products). The DDA is not over and, hopefully, Members will not miss the opportunity to agree on meaningful commitments on environmental services.

[57]United Nations Conference on Trade and Development, *World Investment Report – Transnational Corporations and the Infrastructure Challenge*, 2008.

Annex 1

Environmental Services as Defined in the 1991 UN Central Product Classification[58]

DIVISION 94 SEWAGE AND REFUSE DISPOSAL, SANITATION AND OTHER ENVIRONMENTAL PROTECTION SERVICES

940	Sewage and refuse disposal, sanitation and other environmental protection services	
9401	94010	Sewage services

Sewage removal, treatment and disposal services. Equipment used are waste pipes, sewers or drains, cesspools or septic tanks and processes utilized may be dilution, screening and filtering, sedimentation, chemical precipitation, etc.

Exclusions: Collection, purification and distribution services of water are classified in subclass 18000 (Natural water).

Construction, repair and alteration work of sewers are classified in subclass 51330 (Construction work for waterways, harbours, dams and other waterworks).

9402	94020	Refuse disposal services

Refuse collection and disposal services. Collection services of garbage, trash, rubbish and waste, whether from households or from industrial and commercial establishments, transport services and disposal services by incineration or by other means. Waste reduction services are also included.

Exclusions: Dealing services in wastes or scraps are classified in subclass 62118 (Sales on a fee or contract basis of goods n.e.c.) and 62278 (Wholesale trade services of waste and scrap and materials for recycling).

Research and experimental development services on environmental issues are classified in division 85.

Regulatory administrative services by the government related to environmental issues are classified in subclass 91123 (Administrative housing and community amenity services), 91131 (Administrative agriculture, forestry, fishing and hunting related services) and 91132 (Administrative fuel and energy related services).

9403	94030	Sanitation and similar services

Other sanitation and similar services including outdoor sweeping services and snow- and ice-clearing services.

Exclusion: Disinfecting and exterminating services for buildings and other non-agricultural structures are classified in subclass 87401.

Pest control services in connection with agriculture are classified in subclass 88110 (Services incidental to agriculture).

[58]The complete CPC is available at http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=9&Lg=1.

9404	94040	Cleaning services of exhaust gases

Emission monitoring and control services of pollutants into the air, whether from mobile or stationary sources, mostly caused by the burning of fossil fuels. Concentration monitoring, control and reduction services of pollutants in ambient air, especially in urban areas.

9405	94050	Noise abatement services

Noise pollution monitoring, control and abatement services, e.g. traffic-related noise abatement services in urban areas.

9406	94060	Nature and landscape protection services

Ecological system protection services, e.g. of lakes, coastlines and coastal waters, dryland, etc., including their respective fauna, flora and habitats. Services consisting in studies on the interrelationship between environment and climate (e.g. greenhouse effect), including natural disaster assessment and abatement services. Landscape protection services not elsewhere classified.

Exclusion: Forest and damage assessment and abatement services are classified in group 881 (Services incidental to agriculture, hunting and forestry).

9409	94090	Other environmental protection services n.e.c.

Other environmental protection services not elsewhere classified, e.g. acidifying deposition ("acid rain") monitoring, controlling and damage assessment services.

European Union Competences and Actions in International Environment Law: Recent Developments and Current Challenges

Kirstyn Inglis

Introduction

To talk of current challenges in the Union's competences in the field of international environment law is to talk about the enormity and urgency of the challenge facing the Member States and the Union in balancing economic growth with environmental and human health protection at EU and international levels. The Union's economic development since World War II has been at the expense of the environment, as evidenced by current CO_2 concentrations in the environment and the loss of biodiversity. The Member States and the Union have used a spread of tools to tackle the problems but without succeeding to reverse the trend of unsustainable development. The overarching current challenge facing the Union then, is to find ways for the Member States to move forward collectively in environmental actions so as to meet their objectives and commitments both within the Union and beyond it.

There is an identifiable trend towards a greening of the Union's external relations competences in the Union's pursuit of environmental and climate change ambitions in its bilateral, regional and multilateral legal relations with third countries It is also true that the Union is on its way to meeting its Kyoto commitments for 2012. In the arena of climate change instruments in particular, the Union is emerging as a "maker"[1] of climate change policy: whereas prior to 2000 the EU lagged behind the international arena in terms of climate change actions, since then the EU has been narrowing the gap between its external commitments and its internal actions. Evolution in common EU level actions and competences between the Member States on energy issues has been a major contributory factor to narrowing that gap.

[1]See Oberthür/Pallemaerts, The EU's Internal and External Climate Policies: a Historical Overview, in Oberthür/Pallemaerts (eds.), *The New Climate Policies of the European Union*, 2010, pp. 27–63 (53–55).

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_11, © Springer-Verlag Berlin Heidelberg 2011

Nevertheless, to avoid dangerous anthropogenic climate change, the Intergovernmental Panel on Climate Change highlights that current international – including EU – reduction commitments for CO_2 emissions are wholly inadequate.[2] Internationally, political reality is emblematic of apathy, illustrated by the political and legal impasse in the December 2009 UN negotiations in Copenhagen in December 2009 on the future of the (1997) Kyoto Protocol to reduce CO_2 emissions. Yet Bowen, adviser to Nicolas Stern, maintains that climate change presents less of a challenge compared with establishing the Common Agricultural Policy after World War II.[3] The Union's, and indeed the world's, current political momentum and commitment must be built upon if real results are to be achieved. Hubris in the Union's pretensions at world green leadership risks its own nemesis in the face of climate change, with costs to the World of anything between 5% and 20% of GDP and as yet unknown, unquantifiable costs in terms of human and health costs. The challenge is accentuated by the failure of the 2009 Copenhagen summit in the battle against climate change. The follow-up conference will be held in Cancun, Mexico at the end of 2010. Also in October 2010 is the Conference of the Parties to the 1992 (Rio) UN Convention on Biodiversity. Preventing biodiversity loss is crucial to mitigating and adapting to climate change as it magnifies and speeds up climate change. However, it was already clear in 2009 that the EU had failed to meet its own 2010 target to halt the loss of biodiversity and preparations for a new strategy began in January 2010.[4]

The European Union's competences in the field of international environment law is always a difficult topic because the Member States do not concede full competences to the Union to act in environmental matters. In international environmental agreements, the Union and Member States share competence to take environmental actions, just as they do for internal environmental actions. Competences for environmental actions at EU level, both internally and externally, are shared between the Member States and the Union and their complexity has not been eased by the Treaty of Lisbon (see the below section on the Treaty of Lisbon at the sub-sections on Internal and External Actions). Member States are entitled to take stricter national measures than provisions of EU laws that are based on the Environment Title of the TFEU, including international agreements. Also, the principle of subsidiarity guarantees that action will be taken at the most appropriate local, regional or national level and the principle of environmental integration provides for environmental concerns to be taken into account in all Union actions. This explains the use of so many soft law instruments and political initiatives to

[2] As predicted by the UN's Inter-governmental Panel on Climate Change in 2007, to be found at http://www.ipcc.ch/home_languages_main_french.htm#21. The scientists recommend at least a 25% to 40% international commitment for industrialised countries by 2020.

[3] Referring to the Stern Report, see Stern, *Review on the Economics of Climate Change*, 30 October 2006.

[4] See Commission Communications *A mid-term assessment of the EC biodiversity action plan*, COM(2008) 864 of 16 December 2008 and *Options for an EU vision and target for biodiversity beyond 2010*, COM(2010) 4 of 19 January 2010.

co-ordinate national actions and to programme and supplement more hard law legal instruments for regional or international actions.

Due to recent developments in the Union's external relations and competences in environment law, this paper is necessarily something of a stocktaking exercise. In March 2010 the new EU 2020 Strategy is set to replace the failed Lisbon Strategy, including its sustainable development ambitions. In particular, the emergence of Union competences and actions in the field of energy has become a singular driving force for progress on climate change commitments. The Treaty of Lisbon entered into force on 1 December 2009 and will affect the Union's external actions in many ways, including new areas of shared competence in energy among other fields. An array of recent initiatives are being put in place to create coherence and complementarity between internal and external EU actions, spanning many different areas of action, including financing instruments and development policy. Recognising their historical and moral responsibility for their contribution to climate change, the Member States and the European committed "fast-start" funding of EUR 7.2 billion for 2010–2012 following the Copenhagen summit to the world's poorest countries for combating climate change although it is not yet clear whether those funds will be in addition to Union overseas development aid, or redirected from them.[5]

The first part of this paper introduces the current policy and legal framework for the external dimension to the Union's environment law and its international relationships. It looks at the policy and legal framework for the Union's external actions and introduces the sustainable development aspirations of the new EU 2020 Strategy, commenting on the challenges of realising the Union's external objectives for energy. The second part of this paper deals with the evolutions in Union institutions, representation, competences and procedures following the entry into force of the Lisbon Treaty, particularly in terms of the challenges facing the Union in its external environmental actions.

The Legal and Policy Framework for the Union's External Actions in Environment Policy

Union environment policy is not an exclusive competence of the Union but a shared one: because the environment knows no borders and because certain environmental concerns are best tackled on a more local basis, actions in defence of the environment have to be taken at local, regional and national levels as well as EU and international levels.[6] In 2006 the European Community was listed as being party to over 40 international environmental conventions or multilateral environmental agreements (MEAs), that cover biodiversity and nature protection, climate change,

[5]See European Parliament Resolution *on the outcome of the Copenhagen Conference on Climate Change (COP 15)* of 10 February 2010. This paper was concluded in March 2010.

[6]Since the Treaty of Lisbon, the principle of subsidiarity is now contained in Art. 5 TEU.

protection of the ozone layer, desertification, management of chemicals and waste, transboundary water and air pollution, environmental governance (including impact assessments, access to information and public participation), industrial accidents, maritime and river protection, and environmental liability. The Union's external relations under these instruments are particularly complex legally speaking, in terms of establishing the legal basis in the Treaties for such actions and how that competence is put into practice. The Union's external actions in its dealings with third countries therefore, affect the effectiveness of local, national and Union internal environmental strategies. Also, the continuing environmental degradation experienced by the Union as a result of its economic growth impacts negatively on the environment of third countries as well as on its own.

While celebrating the 50th anniversary of the European Union in Berlin in March 2007, the European Council committed to putting the Union on a new common basis. The laborious working out of the Constitutional Treaty and its subsequent failure in 2005 brought a new urgency to the multiplicity of challenges facing the Union. Having expanded – for the fifth time and on the most ambitious scale in its history – to 25 Member States in 2004 and also having signed another Accession Treaty with Bulgaria and Romania in the April of 2005,[7] the need for an institutional settlement became imperative to the Union's policy objectives in environment policy as in other spheres of Union activity.[8]

The enlargement strategy falls clearly within the Union's external actions. Enlargement is a considerable challenge in itself from an environmental point of view in terms of approximation by aspiring Member States to this hefty and very costly chapter of the *acquis communautaire* as much as in terms of the governance of this chapter in a Union of Twenty-Seven.[9] The Union's ongoing process of enlargement is 'irreversible', with commitments having been made to Turkey and the countries of the Western Balkans in the form of recognition as potential and actual candidates, and is a bilateral process of negotiations (between the EU and each (potential) candidate in turn). While the approximation and governmental capacity building exercise undertaken by acceding countries in itself will not bring about adequate environmental protection in order to make development sustainable, it can be said that remarkable human health and environmental benefits have been brought about with the pre-accession preparations of the ten Central and Eastern European Member States as well as Malta and Cyprus. For the CEEC Member States the environmental benefits in terms of human health alone have been

[7]The fifth Accession Treaty was signed with the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Cyprus, Malta, Poland, Slovenia and Slovakia on 16 April 2003, OJ 2003 L 236/1, as amended.

[8]The sixth Accession Treaty was signed with Bulgaria and Romania on 25 April 2005, OJ 2005 L 157/1, as amended.

[9]See Commission Communication *A Citizen's Agenda: Delivering Results for Europe*, COM (2006) 211 of 10 May 2006.

estimated to have a cumulative value of between EUR 134 billion and EUR 681 billion by the year 2020.[10]

With the incontrovertible pre-requisite that any accession to the Union is impossible without the unanimous agreement of the receiving Member States,[11] the complete approximation of incoming countries to the (environment) *acquis* is non-negotiable, as it ever has been. The strategic approach is ultimately programmed by the Union unilaterally, albeit in the framework of association/partnership and in spite of the impression given by the term "accession negotiations".[12] The enlargement strategy thus makes feasible the coherence, continuity and effectiveness of this aspect of the Union's external action with its internal environmental actions, in a way that other external actions cannot do. The remainder of this contribution focuses on external actions of the Union beyond its enlargement strategy.

The imperative of finding an institutional settlement was all the more so given the external and internal objectives of the Union's environment policy, which have been steadily growing during the 1990s.[13] The emerging external dimension to the Union's environment policy in the 1990s was followed by the Declaration to the Final Act of the Nice Treaty in 2001 (although nevertheless only of declaratory effect), declaring the Member States to be:

> determined to see the European Union play a leading role in promoting environmental protection in the Union and the international efforts pursuing the same objective at global level. Full use should be made of all the possibilities offered by the Treaty with a view to pursuing this objective, including the use of market-oriented incentives and instruments to promote sustainable development.

However, compared to the Union's enlargement strategy, general external environmental actions of the Union in bilateral and multilateral fora do not come packaged up together with any carrot of accession. There is no commensurate driving conditionality to encourage (non-candidate) countries to model their priorities, objectives and policy or legal tools on those of the Union. From the broader external relations point of view, the Union's tasks in its external action and also its partners beyond EU borders, steadily multiplying.[14] In that context, environmental concerns have become increasingly bound up with traditional foreign policy

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[10]See "The benefits of compliance with the environmental *acquis* for the candidate countries and their preparations for accession", a Commission external service contract carried out by Ecotec Research and Consulting Limited, B7-8110/2000/159960/MAR/H1, in 2000, p. xxxix, to be found on the Europa website at www.europa.eu.int/comm/environment/enlarg/pdf/benefit_long.pdf.

[11]See Art. 49 TEU.

[12]See Inglis, The Europe Agreements compared in the light of their pre-accession re-orientation, CMLRev. 37 (2000), pp 1173–1210.

[13]See for example Jans/Vedder, *European Environment Law*, 2008; Krämer, *EC Environmental Law*, 2006.

[14]See Dashwood/Maresceau, Introduction, in: Dashwood/Maresceau (eds.), *Law and Practice of EU External Relations: Salient Features of a Changing Landscape*, 2008, p. 1 et. seq; see Maresceau, *Bilateral Agreements Concluded by the European Community*, 2006.

portfolios: those of trade, development co-operation, humanitarian aid and political dialogue.

Equally important in the formulation and implementation of Union external actions, as in its internal actions, is the integration principle in the Treaties: that environmental concerns must be integrated into the definition and implementation of all Union policies and activities also applies to the Union's external actions, in particular with a view to promoting sustainable development (Article 11 TFEU).[15] In 2000, this principle was enshrined in the Article 37 of the European Charter of Fundamental Rights, now enjoying full legal effect since December 2009 as a result of the Treaty of Lisbon.[16] Improved operation of the environmental integration principle in external actions has to be bolstered by Union conditionality in the drafting of its international agreements as well as the through the programming of all EU expenditure, a theme which arises variously in this paper.

EU Environment Policy: The Legal and Policy Framework for External Action

More substance is being put on the bones of this nascent external dimension to the Union's environment policy by the 6EAP.[17] While the Member States had given a mandate for action in external relations to be built into the fifth Environment Action Programme, itself named *Towards Sustainability*, sustainable development was only inserted into the Treaties by the Amsterdam Treaty of 1997, when it was declared an overarching objective of the Union. The Sustainable Development Strategy (SDS)[18] was established in 2001 and formed an integral part of the Lisbon Strategy. Around this time, the Member States embarked on jointly "greening" their diplomatic contacts with third countries, the Green Diplomacy Network. It is useful to introduce this policy and legal framework before commenting on progress made thereunder and then the challenges that now arise.

a) The Union's *Sixth Environment Action Programme*, adopted in 2002, set the internal policy direction and tasks for the Member States and EU institutions and displays the global ambitions of the Union environment policy between 2002

[15]For the current consolidate version of the Treaty on the Functioning of the Union (TFEU), go to http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:EN:PDF.

[16]See further.

[17]Decision 1600/2002 of the European Parliament and of the Council laying down the Sixth Community Environment Action Programme, OJ 2002 L 242/1; see Commission Communication on the Sixth Environment Action Programme of the European Community *Environment 2010: Our future, our choice*, COM(2001) 31 of 24 January 2001.

[18]For the original strategy, since revised (see further in this contribution), see Conclusions 19 to of the Presidency Conclusions adopted by the 2001 Gothenburg European Council, to be found at http://ec.europa.eu/governance/impact/background/docs/goteborg_concl_en.pdf.

and 2012. The integration of environmental concerns into all aspects of the Union's external relations in the pan-European region and beyond is an objective of the 6EAP. Of the four lead objectives of the 6EAP, top of the list is not only the Union's concern to meet its own internal targets under the Kyoto Protocol for the reduction of its own CO_2 emissions but to press the world community for global CO_2 emissions cuts by 20–40% by 2020. Also, all of the *Thematic Strategies* for policy and legislative development under the 6EAP have definite external components. For example, the Union's *Thematic Strategy on the Sustainable Use of Natural Resources*[19] foresaw the creation of an International Panel on the subject, set up together with the United Nations Environment Programme (UNEP).[20] This thematic strategy for the period 2007–2013 expressly includes energy and all five of its priorities for action include the Unions relations with third countries, including developing countries.[21] Moreover, progress under various headings of the 6EAP is clearly important to the SDS, especially concerning resource use and halting biodiversity loss, climate change and energy initiatives for example.

b) The Lisbon Strategy, adopted by the 2000 Lisbon European Council, aimed to establish the Union as "the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment by 2010". The 2001 (March) Stockholm and (June) Gothenburg European Councils established the guiding principles of the Lisbon Strategy. By doing so, the Member States firmly established that the success of the knowledge economy, within the EU and outside of it, should not undermine social cohesion, partnership in the workplace or environmental protection.

[19] COM(2005) 670 of 21 December 2005.

[20] See Commission Communication, *Halting the loss of biodiversity by 2010 – and beyond. Sustaining ecosystem services for human well-being*, COM(2006) 216 of 22 May 2006. The Union also provides support for third countries in implementing the international Convention on Biological Diversity and funds such efforts through contributions to the Global Environmental Facility.

[21] The five priorities are: to assist developing countries to make better progress on integrating environmental sustainability in decision making and thus underpin achievement of all the Millennium Development Goals by building capacity, supporting the involvement of civil society and developing innovative approaches; promoting implementation of Community initiatives and agreed commitments (including those under Multilateral Environmental Agreements) on environment and sustainable management of natural resources, including energy at international and regional level and across national boundaries; improving environmental integration and promoting coherence in EU policies affecting third countries through methodological work and enhancing expertise; promoting EU environmental policies abroad by strengthening international environmental governance, negotiation and monitoring, assisting the operation of MEAs and other processes, supporting coherent international policy development across the three pillars of sustainable development; promoting EU energy policies abroad, in particular sustainable energy options in partner countries and regions by support for policy development and through innovative funding mechanisms.

c) The Gothenburg strategy firmly establishing the SDS as an axis of the Lisbon Strategy, thus "extending and consolidating" it. Whereas the Lisbon Strategy had the time frame of 2010 in its sights, the SDS is self-standing as a policy framework and has a far longer term perspective, focusing on mainstreaming sustainable development into EU policies. The current, renewed, SDS, adopted by the (June) 2006 Brussels European Council;

> sets out a single, coherent strategy on how the EU will more effectively live up to its long-standing commitment to meet the challenges of sustainable development. It recognises the need to gradually change our current unsustainable consumption and production patterns and move towards a better integrated approach to policy-making. It reaffirms the need for global solidarity and recognises the importance of strengthening our work with partners outside the EU, including those rapidly developing countries which will have a significant impact on global sustainable development.[22]

As a consequence of the SDS therefore, key internal environmental objectives of the Lisbon Strategy concerned:

- Ratifying the Kyoto Protocol and making progress in meeting commitments thereunder;
- Increasing the consumption of renewable energies;
- Decoupling economic growth from resource use and the harmful environmental impacts of such behaviour, as well as;
- Adopting the EU laws on the taxation of energy products and environmental liability and also, the Environment Action Programme which had already been a long time in the policy-making pipeline at that time.

Moreover, with the renewed SDS in 2006, the Commission specifically embarked on giving form and substance to the environmental integration principle in all Union expenditure in external actions.[23] The purpose the *Thematic Programme for Environmental and Sustainable Management of Natural Resources, including Energy* (ENRTP), having a global budget of EUR 804 million, is "to address the environmental dimension of development and other external policies as well as to help promote the European Union's environmental and energy policies abroad".[24]

d) It is also important to mention here the 'Green Diplomacy'[25] initiative of the Barcelona General Affairs Council in March 2002. It came in advance of the World Summit on Sustainable development in Johannesburg that same year. It takes the form of an informal network of environment experts within the Member State's foreign ministries. Its purpose is to integrate Union environmental strategies into the external policies, to contribute to greater coherence

[22] To be found at http://register.consilium.europa.eu/pdf/en/06/st10/st10917.en06.pdf.

[23] See COM(2006) 20 of 25 January 2006.

[24] COM(2006) 20 of 25 January 2006, p. 3.

[25] See www.europa.eu.int/comm/environment/international_issues/. . ..

between the internal and external dimensions as well as to implement the external dimension of the SDS in particular.[26] The relationship between this green network and the EEAS is considered further below in the context of the Union's new External Action Service (EEAS), see the second part of this paper, on the Lisbon Treaty, at the subsection on institutional developments.

What Progress on Greening the External Dimension?

a) Starting with progress under the 6EAP, the Commission's mid-term review in 2007 saw some progress but concluded that the Union was not on a sustainable development path and that many environmental pressures are increasing.[27] Global CO_2 emissions increases is clearly part of the problem. Otherwise, the Commission reported that it was too early to properly assess progress. The European Environment Agency and the European Parliament[28] were highly critical of progress made. The European Environment Bureau, one of the oldest green NGOs in the EU and representing civil society groups across the EU, charged the Union with not making progress beyond the climate change agenda and that:

> Environmental policies have been under pressures, including domination by the Lisbon Process [. . .], a drive for flexibility and soft policies, reluctance by some Member States to agree to a central role for the EU on the introduction of market based instruments, and insufficient environmental policy integration into economic and social policies.[29]

b) For the Lisbon Strategy, poor results were found in the first review, reported on by the High Level Working Group chaired by Wim Kok in 2004.[30] The "disappointing delivery" in achieving the Lisbon Strategy objectives was "due to an overloaded agenda, poor co-ordination and conflicting priorities" at Member State and EU levels and "a key issue has been the lack of determined political action". While a fresh impetus was given the Lisbon Strategy in 2005, the effects of the dramatic global financial crisis that was already beginning at the time, came to a head in 2007 and 2008 and arrested the Lisbon Strategy's 2010 goals outright. The loss of citizens' confidence in banking and financial institutions following the gigantic government interventions required

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[26] See The Action Plan of 15 June 2003, pp. 1–2.

[27] See Commission *Mid-term review of the Sixth Community Environment Action Programme*, COM(2007) 225 of 30 April 2007, p. 29.

[28] See European Parliament Resolution *on the mid-term review of the Sixth Community Environment Action Programme* (2007/2204(INI)) of 10 April 2008; see also "MEPs lament poor EU progress to 2012 green goals", ENDSEurope of 12 February 2008.

[29] See EEB *Response to the Mid-Term Review of the 6EAP*, to be found at http://www.eeb.org/publication/EEB-response-to-the-Mid-Term-Review-of-6EAP-130607.pdf.

[30] *Facing the Challenge: the Lisbon Strategy for growth and employment*, November 2004, p. 6.

to avert an even more dire consequence, triggered a change in tack by the EU Member States. At the beginning of 2008, for the remaining three years of the Lisbon Strategy, the 13 to 14 March European Council undertook to bring climate change/the environment and social issues to the forefront in the remaining years of the Lisbon Strategy.[31] The following section deals with the sustainable development axis of the Lisbon Strategy from an environment view point. The Union's rapid development of the "energy package" is dealt with in the context of SDS below: Union energy actions gained in political momentum at EU level as a result of the Lisbon Strategy priorities and focus on this most important sector directly builds in environment/climate change objectives.

c) As for the SDS itself, equally a measure of progress under the Lisbon Strategy, the review of the renewed SDS was also issued during the last half of 2009,[32] including a Eurostat monitoring report on progress, done by measuring progress against quantitative indicators. Council adopted the report on 10 and 11 December 2009 in time for the Copenhagen summit. In terms of climate change in particular, the Union's internal actions to meet its Kyoto Protocol commitments to reduce CO_2 emissions are on track. Nevertheless, this achievement looks ridiculous in the face of the predicted rise by 2020 of global greenhouse gas emissions to 60% above 1990 levels: the aim of the UN Climate Change Convention is to stabilise emissions at 1990 levels by 2000 in order to avoid dangerous anthropogenic climate change.[33]

The mid-term review reported progess in mainstreaming the SDS agenda into external Union policies: through Sustainability Impact Assessments carried out in the context of the preparation of Free Trade Agreements for example, or work on climate change. The Union pursues its sustainable development strategy in bilateral, regional and multilateral fora including the G8, the United Nations Commission on Sustainable Development (CSD), UNEP and other relevant UN bodies, and the OECD. Since the last review of the Lisbon Strategy, among its neighbouring countries, the Union has promoted dialogue and co-operation with European Neighbourhood Policy partners to promotes sustainable development objectives, as well as through the regional co-operation fora of the Union for the Mediterranean, the Black Sea Synergy and the Eastern Partnership.

Further afield, high level dialogue on the environment has been established with numerous countries, notably Brazil, China, India, Russia, Mexico and South Africa where others already existed, e.g. those with Australia, Canada, Japan and the United States. More expanded co-operation frameworks have been developed with a number of countries, such as India and China. Furthermore, Joint

[31] See Council Press Release 7652/1/08 of 28 May 2008; see also "The Lisbon Strategy gets social makeover", 18 March 2008, to be found at www.EurActiv.com.

[32] See Commisison Communication, *2009 Review of the European Union Strategy for Sustainable Development*, COM(2009) 400 of 24 July 2009.

[33] Commission staff working document accompanying Communication, *Towards a comprehensive climate change agreement in Copenhagen*, SEC(2009) 101 of 28 January 2009.

Declarations on Climate Change have been agreed with the Caribbean Forum, the Pacific Islands Forum and the African Union, and a Joint ACP-EU Declaration was signed.

For developing countries in particular, SDS initiatives include: an EU strategy for supporting disaster risk reduction in developing countries;[34] a Strategic European Framework for International Science and Technology Co-operation;[35] a Staff Working Document on improving environmental integration in development co-operation, which was endorsed strategically by the European Council in June 2009,[36] and; agreements within the Forest Law Enforcement, Governance and Trade (FLEGT) initiative.[37] The initiative began in 2003 to encourage legal logging and eliminate illegal logging through a combination of international actions in producer and consumer countries. Significantly, Voluntary Partnership Agreements (VPA) under the FLEGT initiative have been concluded with Ghana and Congo Brazzaville and negotiations for other VPAs are ongoing with other countries.

The next challenge will be to make this broad approach to mainstreaming meaningful in terms of impact. The determining shift of the Lisbon Strategy early on in 2008 influenced not only the formal review of the Lisbon Strategy but inevitably also its successor, the EU 2020 Strategy, proposed by the Commission on 3 March 2010.[38] Public consultation on the review began in November 2009. A Commission staff working document issued in February 2010[39] highlights the outright failure of the Lisbon Strategy in meeting its aims of reducing unemployment and improving GDP. However, it also praises the Strategy for certain results in terms of promoting common actions among the Member States in order to address the Union's key long term challenges.

From the environment/climate change/energy point of view, the Commission notes that the Union is on its way to achieving its Kyoto Protocol commitments but has pointed to the limited success of the environmental integration actually achieved and to weaknesses in exploiting 'synergies' between the Lisbon Strategy and the SDS.[40] The Commission's EU 2020 Strategy proposal is entitled 'A strategy for smart, sustainable and inclusive growth' and again, climate change

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[34]See Commission Communication on an *EU Strategy for supporting disaster risk reduction in developing countries*, 23 February 2009 and Council Conclusions on a *Community framework on disaster prevention within the EU* of 30 November 2009; see also Commission Communication on a *Community approach on the prevention of natural and man-made disasters*, COM(2009) 82 of 4 March 2009.

[35]COM(2008) 588 of 24 September 2008.

[36]See Council Conclusions on *Integrating Environment into Development Co-operation*, 25 June 2009, where the Council variously supports Union action under the Commission's Staff Working Paper SEC(2001) 609 of April 2001 as well as the SDS.

[37]For full information see the Europa website, http://ec.europa.eu/development/policies/9interventionareas/environment/forest/forestry_intro_en.cfm.

[38]See COM(2010) 2020 of 3 March 2010.

[39]SEC(2010) 114 of 2 February 2010.

[40]See SEC(2010) 114 of 2 February, p. 5.

and energy are core to this strategy. The three ‘mutually reinforcing priorities’, in order, are:

– smart growth: developing an economy based on knowledge and innovation;
– sustainable growth: promoting a more resource efficient, greener and more competitive economy;
– inclusive growth: fostering a high employment economy delivering social and territorial cohesion.

Five head line targets are declared, one of which is to spend 3% of the Union’s GDP on research and development, which is particularly important given the tailing off of spending on research since the 1980s.[41] Another is to keep to the Union’s 20/20/20 targets as part of the Union’s climate change and energy package launched in March 2007 and adopted by the European Parliament and Council in December 2008. Those targets are: to reduce EU greenhouse gas emissions of at least 20% below 1990 levels; to source 20% of EU energy consumption from renewable energy sources, and; to reduce primary energy use by 20% compared with projected levels, by improving energy efficiency.[42]

To make these targets, seven ‘flagships’ are to be launched including one to improve the framework for research and innovation and another for a resource efficient Europe specifically to further and better decouple growth from resource use to support the shift towards the low carbon economy, increase the use of renewable energy sources, modernise the transport sector and promote energy efficiency. Another flagship is designed to support small and medium sized enterprises in the shift to the green economy: called ‘An industrial policy for the globalisation era’.

Pages 14 and 15 of the Commission Communication set out a work programme for both the Commission at EU level and for the Member States. The target date for reaching the new low carbon economy is now 2050. The final bullet point for European Commission actions reads:

> to establish a vision of structural and technological changes required to move to a low carbon, resource efficient and climate resilient economy by 2050, which will allow the EU to achieve its emissions reduction and biodiversity targets: this includes disaster prevention and response, harnessing the contribution of cohesion, agriculture, rural development and maritime policies to address climate change, in particular through adaptation measures based on more efficient use of resources, which will also contribute to improving global food security.

The EU summit of 25 and 26 March is set to formally adopt its replacement, the EU 2020 Strategy. Linkages and input from the SDS are apparent. However, implementation of the SDS itself is criticised for the lack of precise proposals

[41] According the Glynn Evans of the European Commission DG Research, speaking at The 4th Annual Brussels Climate Change Conference 2008, noted that the EU invested four times in energy RTD in 1980 compared to what it invested in 2005, i.e. EUR 8.000 million then and EUR 2.000 million in 2005.

[42] For the content of the legislative package see http://ec.europa.eu/environment/climat/climate_action.htm.

and timetables for actions when it is already clear that the SDS too is not succeeding in its goals as well as lacking the staffing, finance and means for verifying progress under the SDS.[43]

Also important is the fact that the integration of environment and energy into the financing of development actions comes up for renewal in 2010, for the years 2011–2013. The European Council in June 2009 initiated a framework involving the Commission and the Member States, not just the Commission, to prepare and monitor the Union approach to environmental integration. An EU-wide environment strategy on environmental integration in development policy is planned by the end of 2011.

As will be seen at the next part on the Treaty of Lisbon introduces new legal bases on which the Commission can base its prerogative of initiative for proposing measures through which resources and financing can be channelled. Additionally, the new Title XXIII on civil protection provides an entirely new legal basis for actions to respond to natural or man made disasters. However, it excludes approximation of national laws and restricts the potential for Union action going beyond supporting, complementing and coordinating national actions. Hopefully this will mean more funding and staffing to improve implementation and improve the chances of success for both the EU 2020 Strategy and the SDS. In terms of food security in particular, recent initiatives at EU level could be built in to both the shorter term EU 2020 Strategy and the longer term SDS. Work on various aspects of food security at EU level have been building since its Communication *Tackling the Challenge of Rising Food Prices* on 20 May 2008.[44]

In its 2010 working paper,[45] the Commission reports on the mainstreaming of climate change, environmental and transport issues into the Lisbon Strategy since 2005. It is no doubt talking about the world energy scramble as the starting point.[46] The new political momentum for the development of a common, coherent energy policy at EU level was due to soaring oil and energy costs in 2003–2005 and with energy prices becoming increasingly volatile and unpredictable. Global energy production not only no longer keeps pace with demand but continues to grow, while the EU is the world's largest energy importer and must secure its energy supplies from some of the most unstable regions of the world. Until the Treaty of

[43]See Explanatory Opinion of the Economic and Social Committee, *Outlook for the Sustainable Development Strategy*, NAT/440 of 5 November 2009.

[44]See Commission Communication *Tackling the Challenge of Rising Food Prices,* COM(2008) 321 of 20 May 2008. A Commission action plan was adopted on 28 October 2009 to improve the functioning of the food supply chain in Europe, COM(2009) 591 of 28 October 2009. For EU external food security actions, see http://ec.europa.eu/europeaid/index_en.htm.

[45]See COM(2010) 114, op. cit. n. 30.

[46]To quote Javier Solana, the EU High representative for the Common Foreign and Security policy, speaking at the EU Energy Conference held in Brussels on 20 November 2006: "The scramble for territory of the past may be replaced by a scramble for energy. We have to take our energy from where we find it. Although energy markets are increasingly global, much of the world's gas and oil reserves lie in unstable and often undemocratic parts of the world."

Lisbon, the Member States had not as such given the Union policy or legal competence in energy policy. While there was a drive to develop a common energy policy at European level after the devastation of the Second World War, with the creation of European Coal and Steel Community and the European Atomic Energy Treaty, since the 1973 oil crisis the Member States have basically been pursuing their own national energy goals. The Member States were taking co-ordinated and certain concerted legislative actions in energy and energy related subjects but the lack of any specific legal basis in the Treaties for common actions in energy underlines how closely the Member States guard their sovereign independence in energy sector generally speaking and in many ways explained the lack of political investment made by the Member States.

The changing face of the global energy market prompted the EU Heads of State and Government to make energy a new priority in July 2005, to call for a 'common energy' policy in October 2005 and then in December 2005, to call for an 'integrated approach' to energy. First, the Commission proposed the relaunch European Union action in the energy sector in 2005 in order to harness the considerable benefits of reducing energy consumption as a means of achieving the Lisbon Strategy goals: according to 2005 figures the EU could save at least 20% of its energy consumption in a cost-effective manner, equivalent to €60 billion per year, or the combined energy consumption of Germany and Finland.[47] In March 2006 the Commission then launched the Green Paper: 'A European Strategy for Secure, Competitive and Sustainable Energy'.[48]

The subsequent launch of the new EU "low carbon economy"[49] and the Strategic EU Energy Review (SEER) in January 2007,[50] put the external dimension in the context of the internal strategy. The energy package was adopted in December 2008 and took effect in 2009. The objective of its 20/20/20 target comprises a spread of internal EU actions designed to liberalise EU electricity and gas markets, extend and revise the emissions trading system (ETS), raise the Union's renewable energy percentage, increase the use of biofuels in transport, reduce energy consumption by 20% by 2020, focus on research and technological development and revised state aid guidelines.[51]

The Union's energy ambitions are particularly challenging in its external relations, where energy issues are part-and-parcel of broader international security issues and EU foreign policy generally.[52] For reasons already made clear, the actions of third countries are vitally important to the success, from a climate change

[47]See European Commission *Green Paper on Energy Efficiency or Doing More With Less*, COM (2005) 265 of 26 June 2005.

[48]SEC(2006) 105, 8 March 2006.

[49]Commission Press release, *European Strategy for Energy: opportunities and challenges*, Speech 07/109 of 26 February 2007.

[50]COM(2007) 1 of 10 January 2007.

[51]The full extent of policy and legislative measures can be found at http://ec.europa.eu/environment/climat/climate_action.htm.

[52]See Youngs, *Energy Security: Europe's New Foreign Policy Challenge*, 2009.

perspective, of the Union's energy package. From the outset of the SEER, the external ambitions and conditionality of the Union was clear: it even proposed installing infrastructure in third countries, such as independent pipeline for gas supplies from the Caspian Sea or North Africa into the heart of Europe, or new liquefied natural gas terminals. Moreover, it also proposed the 'remodelling' of existing international agreements or introducing new ones. An energy conditionality is now integral to the Union's external relations.

In the context of multilateral agreements, the Union participates in the UN Convention on the Prevention of Climate Change of course, and numerous other international conventions. The 2009 Copenhagen summit emphasised the weaknesses of the Union's energy conditionality as much as its lack of influence in the global arena: the Union found itself sidelined by the BASIC (Brazil, China, India and South Africa) group and the US, leaving high and dry the Union's pretensions at leading by example. The warning of Kremer and Müller-Kraenner is that the "if the Union and its EEAS choose not to take up this new multilateral challenge, Copenhagen could very well be a harbinger of a world order in which international diplomacy will increasingly be shaped by others".[53] The Cancun meeting in 2010 will therefore be a yardstick against which to measure the extent to which the Treaty of Lisbon has indeed improved the Union's external actions from the point of view of its environmental principles and objectives.

On a regional level, the Pan-European Energy Charter Treaty was proposed with Mediterranean and Caspian partner countries and the South East European Energy Community of the Balkans countries. In 2003, the Union launched the European Neighbourhood Policy (ENP), variously developed since: a policy of regional application designed to give more structure and substance to the Union's bilateral and regional relations and encompassing a new generation of bilateral agreements in the region.[54] The strategy provides technical assistance and capacity building in the broader region, directly linked with the principles, priorities and objectives of the Union of course. More recently, in 2007, for example, the Union proposed a Neighbourhood Economic Community to neighbouring countries. In 2008 it made a more concrete proposal for the Eastern Partnership (EaP) for the neighbouring countries of Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine[55] to extend multilateral co-operation, inter alia, in environment policy and climate change.[56] That multilateral co-operation is expressly foreseen in multilateral

[53]See Kremer/Müller-Kraenner, Europe's green diplomacy: Global climate governance is a test case for Europe, IPGlobal, pp. 29, to be found at http://www.ip-global.org/archiv/volumes/volume-11-2010/after-lisbon/europe—s-green-diplomacy.html.

[54]See Hillion, The EU's Neighbourhood Policy towards Eastern Europe, in: Dashwood/Maresceau (eds.), *Law and Practice of EU External Relations: Salient Features of a Changing Landscape*, 2008.

[55]Commission Communication *Eastern Partnership*, COM(2008) 823 of 3 December 2008.

[56]Commission Communication *Eastern Partnership*, COM(2008) 823 of 3 December 2008, p. 12.

conventions and relations with third countries. In all EUR 600 million will be available in 2010–2013.

In particular, again in the context of multilateral instruments, the SEER highlighted the need for Russia, the Union's most important energy supplier, to conclude the 1994 Energy Charter Treaty. A Eurasian legal framework, it has been in force since 1998 and concerns co-operation in energy and is designed to foster investment, protect downstream users and ensure reliable transport of energy products. Russia initially accepted provisional application of the Treaty but continued to refuse to sign the Protocol on Energy Efficiency and Related Environmental Aspects. On 20 August 2009, however, under Article 45(3(a)) of the Treaty, Russia formally terminated even its provisional application of the Energy Charter Treaty by officially notifying that it did not intend to become a Contracting Party to that Treaty nor the Protocol. That termination became effective on 18 October 2009.

In its stead, at a bilateral level, the EU has reverted to concentrating on security of supply of principal energy sources from Russia in the first instance, by reinforcing the Early Warning Mechanism in November 2009 following major disruptions in supply to EU consumers in December 2008 (30% of UE gas supplies were lost due to the Russia–Ukraine dispute, which affected the transit of gas through the Ukraine to the EU).[57] That early warning system dates back to October 2000 when the EU-Russia Energy Dialogue was set up. The ratification of the Energy Charter Treaty would have been – and indeed was recognised in the mechanism itself as – an important complimentary aspect to the system. The early warning mechanism is limited to warning the EU of impending disruptions and has nothing to do with environmental protection or energy efficiency. To be complete, the Union also operates a bilateral Partnership and Co-operation Agreement with Russia since 1994 (in force since 1997). Negotiations were launched in 2008 for its renewal but in spite of seven negotiating rounds to date, there has been little progress on the trade and energy chapters of that agreement, which were based on the ill-fated Energy Charter Treaty. The prospects for progress on the climate change and environmental fronts are all bound up with these chapters. While the Union is also working towards an 'Energy Partnership' with Russia, EU priorities in the 'Energy Dialogue' include environmental protection and a high level of nuclear safety, but Russia's priorities do not, although it does mention energy efficiency as a priority. The EU-Russia relationship highlights the extent of the challenge facing the Union in meeting its external energy goals.

Nevertheless, the Union is clearly pursuing its new energy/climate change strategy through its multilateral and bilateral relationships. Bilaterally, in its neighbourhood and the broader European continent, the Union is eagerly launching initiatives to extend its priorities and objectives to strengthen energy security and environmental

[57]See Commission Press Release IP/09/1718 "The EU and Russia reinforce the Early Warning Mechanism to improve prevention and management in case of an energy crisis" of 16 November 2009. The mechanism itself can be found at http://ec.europa.eu/energy/international/bilateral_cooperation/russia/doc/reports/2009_11_16_ewm_signed_en.pdf.

protection alongside it internal initiatives. The next section of this contribution explores the implications of the new title on energy introduced by the Treaty of Lisbon, see the new and revised legal bases for Eu environmental actions. It considers in particular, whether the Union's new competences in energy and climate change are up to the task of enabling the Union's external environmental ambitions and to maintain and ratchet up the political momentum.

Treaty of Lisbon: Evolutions in Competences and Institutional and Procedural Impacts

With the growing external tasks of the Union as well as the number of its partner countries, the Union institutions had sought to clarify the Union's objectives with its partners through the Constitutional Treaty.[58] Following the failure of the Constitutional Treaty, the European Council convened an Inter-Governmental Conference (IGC) in June 2007 with a precise mandate for elements of a "Reform Treaty" to "amend the existing Treaties with a view to enhancing the efficiency and democratic legitimacy of the enlarged Union, as well as the coherence of its external action". As already clear from the above, and not forgetting the integration principle, the need for the Union/Member States to present one external face in international negotiations is equally as valid in environmental actions as in trade and other external actions. Initially the resulting Treaty failed again, due to the negative referendum in June 2008, only to be accepted by the Irish people on 2 October 2009. It paved the way for the entry into force of the Treaty of Lisbon on 1 December 2009. Certain innovations of the Treaty of Lisbon are of direct relevance to the Union's developing its green credentials both at home and abroad.[59]

The Contribution of the Treaty of Lisbon

While this contribution is concerned with the external dimension of the Union's environmental actions, it is useful to recap on key developments concerning its internal actions first, and then to consider their implications for external EU environmental actions.

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[58]See Commission Communication *Reforming the European Union for the 21st Century*, COM (2007) 412 of 10 July 2007.

[59]For a general introduction to the Treaty of Lisbon see Dougan, The Treaty of Lisbon 2007: winning minds, not hearts, CMLRev. 45 (2008), pp. 617 et seq.

Treaty of Lisbon: Developments in Internal Environmental Actions Having Implications for External Actions

Institutional Developments

Specifically as concerns external actions, the Treaty of Lisbon, the new President of the Council, Herman Van Rompuy, chairs the European Council (Article 15(6) TEU). This is a departure from the rotating presidency among the Member States, separating it from the agenda of the national government of the time, and promises more stability, more consistency and continuity of action.

For the first time ever, under the new Treaty on the European Union, the Council will vote in public on European legislation (not policy per se), which will enable citizens and NGOs to track and take to task the Member State governments should their voting behaviour in reality run counter to their national political manifesto pledges (Article 16(8)), TEU). This is an important evolution in democratic accountability.

As a result of new Treaty competences for energy, see further at, the scope for Union actions in climate change is expanded also in institutional terms. Climate change instruments straddle many sectors of Union activity, not just environment and energy but also agriculture, transport and trade and development policy. To improve coherence and co-ordination between these various activities, the climate change port-folio of Directorate General Environment has been appointed to Connie Hedegaard, and DG Climate Change as it is now known was established on 17 February. Other activities concerning international climate change negotiations have also been transferred to the new DG, together with staff dealing with climate change in the DG Enterprise and Industry. The Commissioner's mandate is to help the EU meet its targets for 2020 and beyond to reduce green house gas emissions and also to develop and implement the Emissions Trading System, ultimately aiming to build an international carbon market.[60] A new DG for Energy is also now established, extricated from DG Transport, under the new Commissioner Günther Oettinger, together with the Taskforce for Energy previously within DG External Relations. Much is hoped of this new constellation, particularly to bring the political rhetoric to practical, legal consequence, especially coherence between climate change and energy actions.[61] For external actions, the success of the overall institutional constellation will also depend on the new High

[60]See press release of 27 November 2009, http://ec.europa.eu/commission_2010-2014/hedegaard/about/mandate/hedegaard_climate_en.pdf; for other organisational consequences, see Commission Press Release IP/10/164 "Commission creates two new Directorates-General for Energy and Climate Action" of 17 February 2010.

[61]See Krämer, Some reflections on the EU mix of instruments on climate change, in Peeters and Deketelaere (eds.), *EU Climate Change Policy*, 2006, pp. 279–296 (284–285). Various Members of the European Parliament involved in the climate change and energy package, however, were critical of the separation between the energy and climate port-folios, see Letter of 7 May 2009, by Avril Doyle MEP et al., to President Baroso.

Representative for Common Foreign Security Policy and the new European External Action Service, dealt with in the section on Institutional developments below.

Internal Actions: Principles Affecting External Actions and Fundamental Rights

In terms of its internal actions, Article 3 TEU now lays out the aims of the Union: paragraph 3 expressly refers to the aim of sustainable development and a high level of environmental protection in the context of the Internal Market while paragraph 5 provides for the promotion of sustainable development in the Union's external actions.

Title I of the TFEU sets out catalogues of competences in terms of exclusive, shared and supporting actions (Arts. 3, 4 and 6 respectively). Of relevance to environmental actions in their broadest sense, this means that:

- Exclusive competence applies to competition rules (including state aid), conservation of marine biological resources under the Common Fisheries Policy and the Common Commercial Policy.
- Shared competence applies to rules on the Internal Market, agriculture and fisheries (where exclusive competence does not apply), environment, consumer protection, energy and public health matters.
- Supporting measures apply to the protection and improvement of public health as well as to tourism.

The legal basis determines the voting majority required by the Member States voting in Council and the input of European Parliament in Union internal actions as well as in its external actions. The implications for international environmental agreements is considered further.

Also, under the Title V TFEU on the Area of freedom, security and justice, provision is made for the adoption of directives "concerning the definition of criminal offences and sanctions in the areas of particularly serious crime with a cross-border dimension resulting from the nature or impact of such offences or from a special need to combat them on a common basis", Article 83 TFEU. The potential external effects of Article 83 TFEU merit further study: it may be useful for improving the performance of the Member States in implementing EU laws that give effect to Union commitments under international agreements.

Last but not least, it is significant that the status of the Charter of Fundamental Rights of the European Union, adopted in 2000, is formally recognised as having legal status. Article 37 of the Charter provides for "[a] high level of environmental protection and the improvement of the quality of the environment must be integrated into the policies of the Union and ensured in accordance with the principle of sustainable development", and thus makes direct reference to Treaty principles set out in both the Internal Market and environment policy legal bases in the TFEU as well as the integration principle, now contained in Article 11 TFEU. However, Article 37 of the Charter is more of psychological value than a justiciable

right.[62] Moreover, the introduction of new integration principles into the Treaty is interpreted by Jans as diluting the effect of the environmental integration principle: "the minestrone effect".[63]

External Actions: Sustainable Development and Environmental Protection

The general provisions on the Union's external action do not specify sustainable development as a principle alongside the other principles guiding its external actions: the principles of democracy and the rule of law, etc. However, Article 21(2) TFEU at paragraphs d and f, provides the basis for coherence between the Union's internal and external environmental actions by reference to the pursuit of sustainable development in external relations in order, respectively, to:

- foster the sustainable economic, social and environmental development of developing countries, with the primary aim of eradicating poverty, and;
- help develop international measures to preserve and improve the quality of the environment and the sustainable management of global natural resources, in order to ensure sustainable development.

New and Revised Legal Bases for EU Environmental Actions

Generally speaking, the major changes concerning the environment *acquis* are: the environment policy chapter is renumbered Articles 191 to 193 TFEU, and;. environment legislation adopted on the legal basis for approximation of laws under Internal Market policy, such as the emissions trading system, is now contained in Article 114 TFEU. With the flurry of activity in energy and climate change involving the shift to the low carbon economy, wider implications can be anticipated in terms of (green) state aid in particular.

The environment title is practically the same as its predecessor title, although measures to combat climate change are now expressly mentioned as an objective of EU international relations [Article 192, fourth indent]. The two legal bases under this title are now Articles 192(1) (qualified majority voting in Council, ordinary legislative procedure involving co-decision of the European Parliament) and 192(2) TFEU (unanimous voting in Council). The Internal Market legal basis remains under qualified majority voting, with the Parliament and Council co-legislating under the ordinary legislative procedure. (The double majority of 55% of the Member States representing 65% of the EU population will not apply until 2014).

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[62] See Dougan, The Treaty of Lisbon 2007: winning minds, not hearts, CMLRev. 45 (2008), pp. 663–671; see also Rossi, How Fundamental is a Fundamental Principle? Primacy and Fundamental Rights after the Lisbon Treaty, Yearbook of European Law 2008, pp. 65–89.

[63] Speaking at the conference on 19 November 2009 on *Environmental Law and Policy in the European Union: the legacy of the Treaty of Amsterdam*, University of Amsterdam.

Various new titles and provisions in the TFEU will also give a concrete legal basis for Union action in support of the various sustainable development actions proposed by the Commission in the – as yet to be endorsed – EU 2020 Strategy. Developments under the Treaty of Lisbon in the Union's external actions are also hoped to improve Union actions in the maritime sector.[64]

The new Title XXI on energy, contained in Article 194 TFEU, explicitly recognises "the need to preserve and improve the environment" and provides legal bases for EU actions by qualified majority voting and with the co-legislation of Parliament and Council to:

- ensure the functioning of the energy market;
- ensure security of energy supply in the Union;
- promote energy efficiency an energy saving and the development of new and renewable forms of energy;
- promote the interconnection of energy networks.

However, just like the Environment Title of the TFEU, the Energy Title also maintains a Member State's right to determine the conditions for exploiting its energy sources, its choice between different energy sources and the general structure of its energy supply. The result is that unanimity with limited participation possibilities for the European Parliament remains in all such areas, alongside fiscal measures, etc., just as is also the case under the environment title of the TFEU, see Article 192(2) (a) and (b) TFEU, not forgetting here that the Lisbon Strategy held energy taxation as a key internal action in order to achieve its objectives.

Eco-taxes offer the possibility of a more efficient way of tackling environmental problems and reportedly "a single economic instrument such as a tax on fuel could replace 117 'regulatory' directives in force in the EU relating to the environment".[65] This is an area where the environmental benefits are potentially considerable[66] but where the need for unanimity has served to prevent some Member States from making progress, holding them back to take account of the more "reluctant" Member States. Generally speaking, there is a potential or perceived risk of damage to a country's competitiveness and price increases. While such fears influence the thinking at national policy level in the use of such instruments, "there is no evidence that existing economic instruments have a major adverse effect on competitiveness on the macro and sector level [. . .] competitiveness issues have been given greater weight than is justifiable".[67]

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[64]See Wouters et al., *Study for the Assessment of the EU's role in International Maritime Organisations*, Leuven Centre for Global Governance Studies, April 2009.

[65]See Burchell/Lightfoot, *The Greening of the European Union*, 2001, pp. 98–100.

[66]Environmental taxes are the most cost-effective instruments for achieving environmental objectives. They encourage actors to allocate their resources more efficiently than would be the case with the command and control approach, which is established in terms of quantifiable results. Revenue tends to go to the general national budget and not for environmental ends. See EEAg Report *Market Based Instruments for environmental policy in Europe*, 2006, pp. 40–49.

[67]See EEAg Report *Market Based Instruments for environmental policy in Europe*, 2006, p. 8.

A major change following the Treaty of Lisbon is that agriculture and fisheries policy and law is an area of shared competence, subject to co-decision of Parliament and Council. The ordinary legislative procedure is extended to agriculture and fisheries, providing new inroads for influence by the European Parliament.[68] However, the conservation of marine biological resources under the Common Fisheries Policy is expressly retained under the exclusive competence of the Union, alongside the Common Commercial Policy. There are also important potential conflicts arising concerning implementing rules for the CAP and competition and state aid rules where the Parliament's input is not provided for.[69] Also, there is no express mention of the objective of sustainable development and environmental protection or improvement in the revised legal bases for CAP legislation, implementation or financing.

One of many instances where the Parliament could push a greener agenda is in the case of the use of agricultural land in order to improve current losses of biodiversity. An EU action plan on the subject of addressing biodiversity loss as a result of the Union's agriculture, has been in place since 2001.[70] A recent report of the European Environment Agency, published in 2010, emphasises the opportunities and suggests ways in which this could be done by means of redistributing support under the Common Agricultural Policy amounting to EUR 53 billion every year.[71] This is an area where the European Parliament could take advantage of this new leverage to pursue one of the four major areas for action identified by the 6EAP. In particular, with its new budgetary powers concerning agriculture and international agreements, the European Parliament has a considerable stick to hand to drive through its agenda, especially in terms of resource efficiency.

These new avenues of influence for the electorate and civil society, through the European Parliament, will no doubt be helped along by open Council voting, opening up national governments to scrutiny for the greenness of their EU decision-making and highlighting where the lobbying – whether by industry or civil society – needs to be focused. Already before the Treaty of Lisbon the European Parliament was criticised for lacking the capacity and the will to fully use the powers available

[68]See Commission Communication on the Consequences of the entry into force of the Treaty of Lisbon for ongoing interinstitutional decision-making procedures, COM(2009) 665 of 2 December 2009. In the Annex 4 list accompanying the Commission's interpretative guidance on ToL, a 75 page and non-exhaustive list of proposals that are already in the legislative pipeline will be affected.

[69]See the drafting of Art. 42 and 43(3) TFEU; see also European Parliament, The CAP and the Treaty of Lisbon, 1 August 2008, to be found at http://www.europarl.europa.eu/ftu/pdf/en/FTU_4.2.9.pdf.

[70]Commission Communication, *Biodiversity Action Plan for Agriculture (Volume III)*, COM (2001) 162 of 27 March 2001.

[71]See EEAg, *Distribution and targeting of the CAP budget from a biodiversity perspective*, Technical Report 12/2009.

to it in the interests of environmental protection.[72] The actual greenness of the European Parliament's future work as co-legislature cannot be assumed, according to a recent empirical study of the European Parliament's behaviour in legislative decision-making.[73]

Treaty of Lisbon: Implications for External Environmental Actions

The Union's external relations with third countries from the perspective of environmental actions are particularly complex in terms of identifying the Treaty competence for Union action as well as how that competence is put into practice. Of the many international environmental agreements to which the Union is now party, particularly relevant at the moment are the multilateral conventions, under the auspices of the United Nations, on climate change (New York, 1992) and on biodiversity (Rio, 1992), which Conventions include the Kyoto and Cartagena Protocols respectively. Also, the European Community had long been a member of international maritime organisations concerning fisheries and other fields of interest.

Earlier sections have demonstrated how the Member States' preoccupation with its external actions on the environmental front, have been emerging in Union policy and legislative agenda and many regional, bilateral and multilateral relationships. However, important institutional limits and legal constraints have held the Member States back from taking common action through the Union in order to pursue EU environmental principles and objectives. This section introduces and comments briefly on certain innovations of the Treaty of Lisbon in the Union's external relations that are relevant to its external environmental actions. This includes institutional changes, such as the new High Representative for Foreign Affairs and Security Policy and the new European External Action Service, substantive and procedural changes concerning international agreements, and the new role carved out for the European Parliament in international agreements.

Institutional Developments: High Representative for CFSP and the EEAS

At Articles 18 to 27 TEU, the Treaty of Lisbon establishes the new High Representative for Foreign Affairs and Security Policy and the new European External Action Service (EEAS), to support the High Representative, which incorporates a role for Member State diplomats to be seconded to the EEAS. On 19 November

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[72]Ludwig Krämer speaking on November 19th, 2009 on *Environmental Law and Policy in the European Union: the legacy of the Treaty of Amsterdam*, University of Amsterdam, see further at subsection c).

[73]See Burns/Carter, Is Co-decision good for the environment? An analysis of the Parliament's Green Credentials, Political Science Studies, Vol. 58, pp. 123–142. http://www3.interscience.wiley.com/journal/122421584/abstract.

2009, the Member States agreed to appoint Catherine Ashton to the post of High Representative. The principle purpose of the High Representative is to conduct common foreign and security policy (CFSP). Acting simultaneously as Vice President of the Commission, she will also be expected to defend Commission interests before the Council, although there is some speculation as to how "associated" the Commission is entitled to be in the conduct of CFSP, due to certain drafting changes under the Treaty of Lisbon.[74]

The Guidelines for the EEAS were agreed on at the 30 October 2009 European Council[75] (hereafter "the Guidelines"). The structure is still to be established by a Decision of the Council, with the consent of the European Commission and after consulting the European Parliament.[76] Thus, the modalities, structures and make-up of the EEAS is not clear yet and has still to be worked out by the High Representative and the Council and the Member States although the deadline for adoption is end April 2010.[77]

Nevertheless, Article 21(3) TEU expressly provides: "The Union shall ensure consistency between the different areas of its external action and between these and its other policies. The Council and the Commission, assisted by the High Representative for Foreign Affairs and Security Policy, shall ensure that consistency and shall co-operate to that effect". The guidelines additionally make clear that the EEAS should also "assist the President of the Council and the President as well as the Members of the Commission [...] as well as closely co-operate with the Member States". The port-folios for enlargement, trade and development will remain with the Commission.

The challenge for the Union will not only be to ensure the necessary and intensive inter-institutional co-operation but in doing so, to balance the Union's green ambitions with other policy priorities as well as to give consequence to the integration principle in the context of its external actions.

While the Guidelines provide for the staff of the EEAS to come from the General Secretariats of the Council and the Commission and also from the Member States, they give no hint as to whether EEAS staff include those with a background in environment policy or the green diplomacy initiative at national and/or EU and international levels: to do so would obviously give consequence to the environmental integration principle. Also, the Guidelines provide at point 24, that "steps should be taken as regards providing EEAS staff with adequate common training", which could easily include training in environmental principles under the Treaties as well as to verse staff in relevant EU policy instruments, such as the 6EAP and the SDS.

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[74] Reference to the Commission being 'fully associated' (contained in ex-Art. 18(4) TEU) have now been deleted.

[75] For the Guidelines, see Council Press Release 14930/49 of 23 October 2009, to be found at http://register.consilium.europa.eu/pdf/en/09/st14/st14930.en09.pdf.

[76] See Art. 27(3) TEU and Declaration 15 to the TOL.

[77] For an analysis of various options, see CEPS Working Paper 28, *The EU Foreign Service: how to build a more effective common policy*, November 2007.

The opportunities for pursuing the environmental principles and objectives of the SDS and the 6EAP cannot be missed in the Union's bilateral and multilateral relations. The need for integrating environmental concerns into the EEAS is obvious. Strategies being drawn up to deal with early warning capabilities, conflict prevention and crisis management are implicated in the Union's strategies to adapt to climate change. Also, various of the Union's financing instruments for external actions must also integrate environmental concerns.[78]

Part of rising to that challenge will also depend on how the Union takes advantage of and develops 'green diplomacy'. The EU Green Diplomacy Network, initiated by the March 2002 Barcelona European Council, functions outside of the Union's institutional framework as such: it is an informal network of national foreign ministries to integrate environmental concerns into the Union's external policies. The network has much to its credit, particularly in terms of the congruency of the Member States in their unity to defend common climate change priorities and a considerable degree of "Europeanisation" of national representatives representing EU positions in international negotiations.[79] All the same, it is a time-consuming network and guaranteeing its input, coherence and consistency with the EEASs actions in green diplomacy will have to be a challenge in itself.

International Environmental Agreements: Competences and Procedures

Environment policy is highly politically sensitive because of its implications for other areas where the Member States intentionally decline to concede sovereignty. Environment policy per se remains an area of shared competence, pursuant to Article 2(2) TFEU. Article 191(4) TFEU provides: "Within their respective spheres of competence, the Union and the Member States shall co-operate with third countries and competent international organisations. The arrangements for Union co-operation may be the subject of agreements and the third parties concerned". It then also reiterates that this paragraph "shall be without prejudice to Member States' competence to negotiate in international bodies and to conclude international agreements". Furthermore, the principle that Member States may always take more stringent measures than Union actions, now contained in Article 193 TFEU, is applicable to international agreements adopted under the Environment Title of the TFEU.

[78]See Council Conclusions on *Integrating Environment into Development Co-operation*, 25 June 2009, where the Council variously supports Union action under the Commission's Staff Working Paper SEC(2001) 609 of April 2001 as well as the SDS.

[79]See van Schaik, The Sustainability of the EU's Model for Climate Diplomacy, in: Oberthür/ Pallemaerts (eds.), *The New Climate Policies of the European Union*, 2010, pp. 251–280 (264–269); see also Schunz/ Happaerts/van den Brande, *European Union Foreign Policy and Global Climate Change: towards a Comprehensive European Climate Diplomacy*, Leuven Centre for Global Governance Studies, October 2009.

However, various instances have arisen in past practice where multiple legal bases are concerned which involve mutually incompatible legislative procedures: where for example, an agreement has aims falling under the CCP (exclusive competence) and the environment and energy (shared competence) legal bases in the TFEU. Two cases on this question arose in 2003 concerning the Union's implementation of the Rotterdam Convention in on Prior Informed Consent for certain hazardous chemicals and pesticides in international trade.[80] Contrary to the arguments of the Members States, the Commission and the Parliament, the Court established both the CCP and environment legal bases to be equal. The case law of the European Court of Justice is generally complex here but is essential to understanding how an international agreement of the Union may be characterised and to establish the legal basis for the agreement, which is necessary to establish competence.[81] The catalogues of competences listed in Articles 3, 4 and 6 TFEU do not resolve the dilemma of identifying the predominant purpose of a given act that cross-cuts various legal bases. Input from the ECJ will no doubt continue to be necessary on a case by case basis.[82]

In terms of the Union's external representation, where the Union enjoys exclusive competence, the Commission may represent the Union, upon mandate of the Council. In contrast, Union competence for both the climate change and biodiversity Conventions is shared. It is clear then, that the legal basis for international or multilateral environmental agreements is essential and that "mixity" endures in environment agreements: the Member States, in their own capacity, and the Union, with its legal personality, are entitled to participate in international organisations. The Treaty of Lisbon does not interfere with the way in which the Member States exercise their competence. It may be that the Member States mandate the Commission or the President of the Council to exercise their competence, but again the Treaty of Lisbon is silent on the ways and means of doing so. Consequently, while the Treaty of Lisbon rationalises the Union's external representation in its external environmental actions, it has not unified it: there is still no one individual to whom third countries and international organisations may apply or to sign the agreement. It could be that the Union and the Member States choose to be represented by the new President or, as has been the case to date, by the Commission under mandate of the Member States in Council. That said, however, Article 17(1) TEU provides that "With the exception of the common foreign and security policy, and other cases

[80]ECJ Case C-94/03, *Commission v. Council*, [2006] ECR I-1 and ECJ Case C-178/03, *Commission v. European Parliament*, [2006] ECR I-107.

[81]See Cremona, Defining competence in EU external relations, in: Dashwood/Maresceau (eds.), *Law and Practice of EU External Relations: Salient Features of a Changing Landscape*, 2008, pp. 34–69. Relevant case law referred to includes ECJ Opinion 2/2000, *Cartagena Protocol on Biosafety*, [2001] ECR I-9713; ECJ Case C-281/01, *Commission v. Council* – Energy Star Agreement, [2002] ECR I-12049.

[82]See Cremona, Ibid. at p. 69.

provided for in the Treaties, [the Commission] shall ensure the Union's external representation", although it would not make sense that this phrase could be used to deprive Member States of their right to be party to such agreements.

The legal basis for Union action determines the decision-making procedure for the Union's exercise of its competence. Article 216(1) TFEU enables the Union to conclude agreements with third countries and international organisations while Article 216(2) TFEU legally binds the Union and the Member States under those agreements. The pre-Lisbon EC Treaty provided for the negotiation by the EC and the Member States of international agreements with third countries and international organisations under the Article 300 EC Treaty procedure. The new version of that Article is now contained in Article 218 and is not substantively different, although the Union replaces the Community.

The European Parliament in External Actions

The European Parliament will enjoy extended inclusion in the Union's external actions as a result of the extension of its competence concerning international negotiations. Under Article 207(3)(3) TFEU, the Commission is obliged to report regularly to the European Parliament on the progress of negotiations and not just to the Council. Also, by virtue of Article 207(2) TFEU, the European Parliament enjoys more competence in the implementation of the Common Commercial Policy (CCP). Traditionally this has been an area of exclusive competence of the Union without involving the Parliament's contribution to negotiations or implementation. Today the ordinary legislative procedure involving the European Parliament as a co-legislator alongside the Council, will apply to implementing measures under the CCP, which inevitably provides the Parliament with a route to influence the conclusion of CCP agreements.[83]

It should also be mentioned that while generally speaking the Parliament must be consulted on agreements between the Union and third countries or international organisations (Art. 218(6)(b)), its actual consent must be secured in relation to certain environmental agreements themselves or other agreements containing environmental provisions. Article 218(6)(a)(i) provides for the European Parliament's consent to be given to bilateral association agreements, typically providing for approximation to environment *acquis*, and regional co-operation in environment protection generally. By virtue of Article 218(6)(a)(v), the Parliament's consent is also required in respect of 'agreements covering fields to which either the ordinary legislative procedure applies, or the special legislative procedure where consent by the European Parliament is required'.

[83] Müller-Graff, The CCP enhanced by Reform Treaty of Lisbon?, in: Dashwood/Maresceau (eds.), *Law and Practice of EU External Relations: Salient Features of a Changing Landscape*, 2008, pp. 188–201 (198–199).

Thus, the Parliament's consent is necessary for international agreements between the Union and third countries or international organisations. Such an extension of competence for the European Parliament offers new channels of leverage for its environmental ambitions. However, the 'greenness' of its input and its willingness to fully inhabit the potential for its contribution to the evolution of Union environmental actions, is not necessarily to be assumed. To summarise Krämer very crudely,[84] there are many counts on which the Parliament has shown that it lacks the initiative or will to act: the political groups are not homogenous and national parties do not have their own environmental programmes, nor indeed does the Parliament itself; the Parliament "has no historic memory" in that it "forgets" to follow up on its positions and agreements with the Commission/Council in later reviews of environment laws; the Parliament is essentially reactive to the Commission and lacks the know-how and resources of its co-legislator in Council to come up with its own action plans; the Parliament does not follow up on progress under the 6EAP and fails to take up legal redress opportunities provided it in the Treaties; the Parliament does not reproach and hold to task the European Commission concerning reporting on legislative implementation.

Conclusions

Given that the environment knows no borders, the Union's external relations and actions in environmental matters are crucial to its internal climate change/biodiversity and energy agendas and its sustainable development agenda generally. Back in 2004, the High Level Working Group identified the need for a sense of urgency in the political commitment to the Lisbon Strategy and the SDS in order to make the sustainable, knowledge based Union a success. Despite its many environmental actions, the Union's lack of progress at the climate change summit of 2009 and failure to meet actions to halt biodiversity loss underlines the need for more urgency in political commitments and actions. Garnering international political support is a considerable part of the challenge. The objectives of the new EU 2020 Strategy also require a renewed sense of political urgency. The SDS and the 6EAP are unavoidably all the more of a challenge in this time of the post-financial crisis, as well as the outcome of global climate change summit in Copenhagen in December 2009 and the new energy package.

Following the entry into force of the Treaty of Lisbon, the future of in the Union's external environmental actions for the moment depends on many unknowns. The make-up and functioning of the new EEAS and how it works with the Green Diplomacy initiative will be important. The institutional constellation and chemistry of the interaction between EU institutions and Member States will be determinant in whether the EEAS will truly be capable of greening its external action. How the new

[84] See notes 72 and 73 above.

Energy and Climate Change Directorates of the European Commission will be part of that overall chemistry is also important. The European Parliament too has a considerable potential, especially with its new competences and particularly its budgetary powers as a result of the Treaty of Lisbon, to ratchet up the political momentum and the policy coherence and effectiveness. Also, the Union's external representation remains complex in areas where the Union shares competences with the Member States, especially in multilateral fora, such as the UN Conventions on Climate Change and on Biodiversity.

Whether the Member States and the Union's institution will take up the gauntlet of the environmental challenge remains to be seen.

Part II
Regional Integration

The European Union and Regional Trade Agreements: A Case Study of the EU-Korea FTA

Colin M. Brown

Introduction

The predecessor article[1] to the present provided a systemic overview of all of the European Union's[2] regional trade agreements (RTAs). Rather than follow the approach of providing a detailed update to that overview, the present article concentrates on analysing the EU-Korea Free Trade Agreement (FTA).

The EU-Korea FTA,[3] which was initialled on 15 October 2009, and which will be subject to at least the first steps of ratification during 2010,[4] represents a significant development in EU RTA practice. First, it is the first Global Europe FTA agreement. In other words, it is the first agreement for which negotiations have been completed according to the strategy announced in the Global Europe

The views reflected in this contribution are personal, and should not necessarily be attributed to the European Commission. The author would like to thank Justyna Lasik for her assistance in the preparation of this article.

[1]Cremona, The European Union and Regional Trade Agreements, EYIEL 1 (2010), p. 245.

[2]On 1 December 2009, with the entry into force of the Treaty of Lisbon the European Community was replaced by the European Union. As a consequence, while some of the matters discussed in this article took place before 1 December 2009, this article uses the term European Union (EU).

[3]The initialled text is publicly available at http://trade.ec.europa.eu/doclib/press/index.cfm?id=443&serie=273&langId=en.

[4]The European Commission adopted the proposals for the Council decisions to sign and conclude the agreement on 9 April 2010 (COM(2010) 136 final and COM(2010) 137 final). The consent of the European Parliament is required after signature and before conclusion. Given that the agreement is considered to be a mixed agreement, it will also be necessary to have it ratified pursuant to the constitutions of the Member States. This means that the definitive entry into force of the agreement will take some time. The Commission proposed that substantial parts of the agreement would be provisionally applied pursuant to Article 218(5) of the Treaty on the Functioning of the European Union (TFEU).

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_12, © Springer-Verlag Berlin Heidelberg 2011

Communication of the European Commission, which explicitly sought to focus the EU's trade policy on improving the EU's competitiveness in the world economy, e.g. by concluding FTAs with key emerging markets.[5] Second, it will be the first major agreement subject to the consent of the European Parliament subsequent to the entry into force of the Treaty of Lisbon.[6] Quite apart from its relevance in EU trade policy, it is, in global terms, a hugely significant agreement. It is considered the second most significant bilateral trade agreement in trade terms after the North America Free Trade Agreement.

This article, after providing some more detailed background on the genesis of the EU-Korea FTA, provides a description of its main features and an analysis thereof. It thereafter offers some tentative conclusions on the agreement.

Background

Why Korea?

Korea was identified along with India and the ASEAN countries as an important target for an FTA in the 2006 Global Europe Communication. The EU explicitly sought to focus its trade policy on markets offering significant new export opportunities. An obvious focus was on the fast growing Asian economies, which offered significant growth rates and hence potential for exports, but which were often combined with high levels of protection.

Korea is the fourth largest export market for the EU outside Europe, but European exporters of goods and services face significant obstacles to access the Korean market, both in terms of tariffs (average tariffs of 6.8% for industrial and 48.3% for agricultural goods) and regulatory obstacles to trade. A study commissioned in 2007 estimated that the FTA will create substantial new opportunities in trade in goods and services of a value of €19.1 billion for the EU and €12.8 billion for Korea.[7]

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[5]Commission Communication *Global Europe: Competing in the World*, COM(2006) 567 final, 4.10.2006. The other countries identified as part of the Global Europe strategy were India and the ASEAN countries.

[6]The Treaty establishing the European Community, before it was revised by the Treaty of Lisbon to become the Treaty on the Functioning of the European Union, also foresaw that the "assent" of the European Parliament for certain international agreements would be required when certain conditions were met (Article 300(3) second subparagraph). It was likely that the EU-Korea FTA would have fallen under those conditions in any event, before this question was rendered moot by the entry into force of the Treaty of Lisbon. However, the entry into force of the Treaty of Lisbon has brought about a sea change in the importance of the European Parliament to the conduct of trade policy; its consent is required for all trade agreements, rather than a very limited few, and it is co-legislator with the Council for all trade legislation whereas previously the Council had legislated alone.

[7]Copenhagen Economics/Francois, Economic Impact of a Potential Free Trade Agreement between the EU and South Korea, available at http://trade.ec.europa.eu/doclib/docs/2007/march/tradoc_134017.pdf.

Moreover, Korea has been very active in negotiating FTAs with competitors of the EU. In particular, Korea has negotiated an FTA with the United States which at the time of writing was pending ratification.

Process

In April 2007, the Council authorised the European Commission to negotiate the EU-Korea FTA, while at the same time authorising negotiations with India and the ASEAN countries. Negotiations on the EU-Korea FTA progressed more rapidly than those with India or the ASEAN countries.[8] Negotiations began in May 2007 and after eight rounds of negotiations the agreement was initialled on 15 October 2009. Negotiations were conducted in close consultation with the representatives of the Member States of the European Union in the so-called 133 Committee.[9] The Commission also frequently informed the European Parliament of the negotiations with Korea, and sought to pursue the objectives set out in the European Parliament's resolution of 13 December 2007 on trade and economic relations with Korea.

Main Features of the FTA

Overall Structure

The Agreement is divided into 15 chapters with numerous annexes.[10] Broadly speaking the chapters can be divided into four. First, chapters 2–6 deal with trade in goods (market access for goods, technical barriers to trade, trade remedies, sanitary and phytosanitary measures and customs and trade facilitation). Second, chapter 7 deals with services and establishment (i.e. investment). Third, chapters 8–13 deal with rules associated with trade (capital movements, public procurement, intellectual property, competition, transparency and trade and sustainable development). Finally, a number of chapters deal with institutional and general provisions, the most notable of which is a dispute settlement mechanism broadly based on the WTO's dispute settlement system.

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[8]As regards ASEAN, the initial approach of seeking a region-to-region agreement was suspended, in favour of seeking bilateral agreements. Negotiations on an EU-Singapore FTA were the first to be opened in early 2010.

[9]Since 1 December 2009 the "Trade Policy Committee".

[10]It is to be noted that the structure of the agreement is different from that typically negotiated by the European Union in that the numbering is not sequential, but by chapter, and annexes are attached to chapters, rather than to the agreement as a whole. The structure is rather similar to a US FTA.

As can be seen, the agreement goes substantially beyond an agreement which would eliminate tariffs on goods and restrictions on the provision of services in line with Article XXIV GATT and Article V GATS. It is intended to reach beyond border measures and bring about changes to the regulatory environment of the parties. In that sense, it is a major development in the EU's FTA practice.

The next sections examine these divisions in more detail.

Trade in Goods

Tariff and Non-Tariff Barriers

As with any classical FTA, the agreement foresees the removal of tariffs on substantially all trade between the parties in order to ensure conformity with Article XXIV GATT.

Chapter 2 of the Agreement deals with tariff and non-tariff measures. It contains provisions providing for the elimination of tariff duties, as set out in the tariff schedules to the Agreement contained in Annex 2A. This is done over a transitional period. The majority of customs duties on goods will be removed already at the entry into force of the agreement.[11] Practically all customs duties on industrial goods will be fully removed in year 5 of the tariff elimination schedule. By year 7, both Parties would have eliminated duties on all industrial products and have achieved, in overall terms, 98.7% of tariff elimination in terms of trade and 96.2% in terms of tariff lines. A limited number of highly sensitive agricultural and fisheries products have transitional periods longer than 7 years. Rice and a few other agricultural products are excluded from the Agreement.

As regards Korea, the import of a certain number of agricultural products originating in the European Union are subject to tariff rate quotas. These tariff rate quotas, and certain rules for their management are set out in Annex 2-1-A. Article 2.7 also contains specific rules. These rules are more detailed than the rules which would otherwise be applicable pursuant to the WTO Agreement on Import Licensing. As regards imports of certain Korean agricultural products into the EU, the agreement provides for a specific application of the EU's entry-price system more favourable than that which the EU provides on a most-favoured nation basis. As is required by Article XXIV GATT, export duties are included in the calculation of substantially all trade and are prohibited.

Chapter 2 also contains rules on non-tariff barriers. Chapter 2 repeats some of the relevant GATT 1994 provisions, such as Article III GATT. Article XX GATT is expressly incorporated. The key innovative feature of the agreement is the inclusion of sectoral rules dealing with certain non-tariff matters. As a result, the agreement

[11] Note that the date of entry into force of the agreement is the date of provisional application of the agreement, if it is provisionally applied. See Article 15.10.5(d) of the Agreement.

includes sectoral annexes dealing with electronics, motor vehicles and parts, pharmaceuticals and medical devices and chemicals. These are set out as annexes to chapter 2.

This is a major innovation, and the first time that an EU trade agreement explicitly addresses specific sectoral non-tariff barriers. The logic behind this development is that even if tariff barriers are substantially removed, real market access depends also on the relevant regulatory systems and the extent to which import products can meet the requirements of the regulatory system. This is perceived as being particularly relevant as regards the Korean regulatory system. The sectoral annexes focus on those areas which were considered particularly important.

In broad terms, the sectoral annexes focus on ensuring the application of international standards, or ensuring the acceptability of EU standards in Korea. For example, the annex on electronics identifies, for the purposes of the TBT Agreement, the relevant international standard setting bodies, which in turn national regulations must be based on. Further, the annex eliminates in almost all circumstances the need for duplicative testing for entry into the Korean market, permitting the supplier to make a declaration of conformity. The annex on motor vehicles requires that United Nation Economic Commission for Europe (UN-ECE) standards (which are used in the EU) will be considered as equivalent to Korean standards, and indeed that Korea align certain of its standards on UN-ECE standards. The agreement also provides that EU car makers will have flexibility to comply with the Korean emission standards, by providing for specific emission levels for car makers with sales in Korea below certain thresholds. As regards pharmaceutical products and medical devices the sectoral annex imposes various requirements increasing the transparency by which health authorities set prices for reimbursement and permitting judicial review of such pricing decisions.

Trade Remedies

Chapter 3 of the Agreement concerns trade remedies. The main focus of the chapter is the bilateral safeguard instrument which permits the imposition of safeguard measures under the Agreement. The triggers for the application of safeguard measures are largely based on the WTO Agreement on Safeguards. The parties are permitted to impose safeguard measures either by suspending further reductions provided for in the agreement or by imposing a duty which can be no higher than the lower of the MFN duty applied at the time the measure is taken or the base rate from which reductions are calculated as specified in the Agreement. In distinction to GATT Article XIX safeguard measures are not available after the end of the tariff elimination process. The Agreement also includes a special agricultural safeguard, modelled on the safeguard procedures in Article 5 of the WTO Agreement on Agriculture. There are also provisions which deal with certain specific elements of trade defence instruments (e.g. requiring that documents in English be accepted in anti-dumping investigations, or requiring that the lesser duty rule apply).

Other Provisions on Goods

Other chapters concerning trade in goods include chapters setting out a framework, largely inspired by the WTO, for co-operation on technical barriers to trade and on sanitary and phytosanitary measures. This section of the Agreement finally has a chapter dealing with customs and trade facilitation which sets down certain standards for customs processing and provides for co-operation between customs authorities.

Trade in Services and Investment

The agreement also contains substantial commitments liberalising trade in services as required by Article V GATS. Both the EU and Korea will substantially liberalise their services commitments beyond the level of liberalisation contained in their WTO schedules. The Agreement also provides market access commitments on establishment (investment) in both the services sector and the non-services sector.

The text of services and investment part of the agreement is similar to the text on services and investment included in the EU-CARIFORUM agreement[12] and follows the model set out in the EU's so-called minimum platform on investment. The provisions are divided into three sections, one on the cross-border supply of services, one on establishment and one on the temporary presence of natural persons for business. It is to be noted that the establishment provisions have a review clause which mentions the possibility of negotiations on "general principles of investment protection". This was negotiated before it was known that the Lisbon Treaty would enter into force. The Lisbon Treaty amended the former Article 133 of the Treaty establishing the European Community (now Article 207 of the Treaty on the Functioning of the European Union) and gave the EU competence to negotiate investment protection provisions. It remains to be seen if and when negotiations on investment protection would take place. If they were to take place, it would lead to the Agreement covering in principle all relevant areas of international economic law. This would be a first in the EU's practice (depending on the outcome of other ongoing negotiations).

The Agreement contains also detailed regulatory frameworks, which set out general rules on regulation and then detailed rules for a number of services sectors; computer services, postal and courier services, telecommunications services, financial services, international maritime transport services and electronic commerce.

Importantly, audiovisual services are excluded from the chapter. This is in line with longstanding EU policy on the treatment of audio-visual services. The Agreement also contains a Protocol on Cultural Co-Operation. This Protocol sets out a number of procedures to permit co-operation between the EU and Korea on cultural

[12] Economic Partnership Agreement between the CARIFORUM States, of the one part, and the European Community and its Member States, of the other part, OJ 2008 L 289/1.

issues, and permits, for example, Korean cultural actors to benefit from EU programmes for co-productions and vice versa. During the negotiations, the EU insisted that the application of the Protocol on Cultural Co-operation would only be possible if Korea ratified the UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expressions. The Agreement provided, in effect, that this part of the Agreement could enter into force after the rest of the Agreement, if Korea had not ratified this Convention. Since Korea ratified the Convention on 15 April 2010, such a scenario will not arise.

Rules Associated with Trade

Government Procurement

Both Korea and the EU are parties to the WTO Agreement on Government Procurement (GPA). Chapter 9, which deals with government procurement, is built therefore on the GPA. However, rather than build on the existing GPA the Parties chose to incorporate a text (with certain limited exceptions) which has been agreed between the negotiators of the parties to the GPA in December 2007 but which has yet to be ratified.[13] In fact, the GPA negotiations have stalled as the GPA Parties discuss the extent to which they will extend the coverage of their commitments under the GPA. At the time of writing these negotiations have not been completed, and so the ratification process of the revised GPA has not started. This makes the Agreement the first international agreement to make effective the revised GPA rules. It is striking that the EU and Korea have agreed that their bilateral procurement should be covered by the new rules when there is ultimately no guarantee that the revised GPA will actually eventually enter into force.

In terms of coverage, the Parties take commitments to open procurement not covered by their GPA commitments to goods, services and suppliers of the other Party. These include specific commitments on BOT (Build-Operate-Transfer) contracts and public work concessions.

Intellectual Property Rights

The intellectual property chapter (chapter 10) goes significantly beyond the WTO TRIPs Agreement. It sets out detailed prescriptive rules for a number of sectors of intellectual property rights. Particular mention can be made of the extensive provisions on copyright and the protection guaranteed for rights holders. The provisions on geographical indications (GIs) are also quite extensive. The Agreement protects agricultural GIs on the same footing as GIs for wines and spirits, going beyond

[13] WTO Document negs 286(Job no[1].8274), dated 19 November 2007, available at http://www.wto.org/english/tratop_E/gproc_e/gp_gpa_e.htm (last visited on 16 April 2010).

WTO provisions. Over 200 GIs (both European and Korean) are protected by the Agreement, and the Agreement contains provisions which permit new GIs to be added to that list.

The Agreement contains very detailed rules on the enforcement of intellectual property rights, which go beyond those provided for in the TRIPS Agreement. These provisions on the enforcement of intellectual property rights are to a large extent inspired by EU internal market rules on the enforcement of intellectual property rights.

Competition

In another important development, the Agreement contains detailed rules on competition law. In particular, the Agreement requires the parties to maintain competition laws and prohibits cartels, abuse of dominant position and mergers which impede effective competition in so far as they effect trade between them. The Parties agree to maintain competition authorities, which are required to respect procedural due process rights. Competition law is also applied to public enterprises and entities with special or exclusive rights except where this would obstruct the performance of the tasks entrusted to such entities. This system is based on the EU's internal system. It is notable, however, that the Agreement's dispute settlement system does not apply to this part of the Agreement.

The section on subsidies contains an agreement of the Parties to remedy or remove distortions of competition caused by subsidies in so far as they affect international trade. This section is particularly significant in so far as it contains provisions that prohibit certain types of subsidies, which are not, as such, prohibited by the WTO Agreement on Subsidies and Countervailing Measures. The prohibited subsidies are those covering debts or liabilities of an enterprise without any limitation, in law or in fact, as to the amount or duration and subsidies to ailing enterprises, without a credible restructuring plan based on realistic assumptions that would allow the recipient to return to long term viability without further reliance on government support. There are also transparency provisions requiring annual reporting on the total amount, types and the sectoral distribution of subsidies. The rules on subsidies apply to goods but not subsidies to agriculture products nor fisheries subsidies. They do not explicitly apply to subsidies for services, although there is an agreement to review the situation within 3 years of the entry into force of the Agreement. In contrast to the section on competition law, this section is subject to dispute settlement.

Transparency

The Agreement puts in place certain transparency requirements which again go significantly beyond WTO requirements. This is a reflection of the significant effect that domestic regulations have on the effectiveness of a trade agreement. In

particular, the Chapter provides that interested persons be given reasonable opportunities to comment on proposed new regulatory measures and provides for enquiry or contact points to respond to questions arising from the application of regulations and to seek to resolve problems arising from such regulations. The Chapter also contains detailed due process requirements concerning administrative proceedings and the possible review or appeal of administrative actions in areas covered by the FTA.

Trade and Sustainable Development

The Agreement contains important provisions setting out commitments and a framework for cooperation on trade and sustainable development. The Parties reaffirm their commitment to a significant number of International Labour Organisation conventions and multilateral environmental agreements. As regards labour, the FTA is used to put in place a commitment to ratify and effectively implement all "up-to-date" ILO conventions. This includes conventions additional to the core labour standard conventions. Of some significance is the inclusion of a clause prohibiting a failure to effectively enforce environmental or labour law in a manner affecting trade or investment between the Parties. A similar prohibition applies to the weakening or reduction of standards. The EU has included similar clauses in the EU-CARIFORUM agreement.

The chapter also includes significant institutional innovations. For example, Domestic Advisory Groups (made up of civil society) are created which will advise on the implementation of the sustainable development provisions. The key innovation is the creation of a consultation process by which a matter not satisfactorily addressed through government consultations can be referred to a panel of experts which is in turn required to hear the parties and issue a report. The panel of experts should seek the advice of the Domestic Advisory Groups and competent international organisations, such as the ILO or relevant multilateral environmental organisations. The reports of the panel will be made publicly available to the Domestic Advisory Groups. The Parties are required to "make their best efforts to accommodate advice or recommendations of the panel of experts". The sustainable development section of the Agreement contains a special sui generis arbitration system different from that included in the dispute settlement chapter.

Institutional Provisions

Dispute Settlement

Chapter 14 of the Agreement contains the provisions on dispute settlement. The dispute settlement chapter is largely based on the WTO Dispute Settlement Understanding. However, it has a number of differences some of which can be considered

as improvements over the WTO system, some of which are inherent in the bilateral setting of such an agreement. The dispute settlement process is significantly quicker than the WTO system (150 days between the establishment of a panel and its report). Further, it provides for a permanent list of panellists, rather than following the WTO practice of choosing ad hoc panellists. In the absence of agreement, panellists are to be drawn by lot. It contains improved rules on transparency. For example, hearings of the panel will be open to the public and interested persons will be able to file amicus curiae briefs. There is no appellate forum. This model of dispute settlement is one which the EU has pursued in all of its substantive trade agreements for the last 10 years.

The chapter also addresses the relationship between dispute settlement under the FTA and WTO dispute settlement. Article 14.19 provides that the provisions of the chapter are without prejudice to possible dispute settlement under the WTO but goes on to state that the Parties will not pursue dispute settlement under both systems as regards the same measure until the first proceeding has finished and that a party shall not seek redress of an identical obligation in both forums unless the selected forum fails to rule on the particular matter because of jurisdictional or procedural reasons.

Of quite some significance is the inclusion of a mediation mechanism that the parties can use to tackle market access problems due to non-tariff measures. The mechanism is not intended to review the legality of a measure, but rather to resolve a market access issue without recourse to litigation. As such, it is a manifestation in a bilateral setting of efforts in the WTO to create precisely such a mechanism at multilateral level.[14] The mechanism functions through the appointment of a mediator who delivers an advisory opinion and a proposed solution to the problem within a specific period of time. The mechanism does not exclude the possibility to have recourse to dispute settlement.

Horizontal Institutional Provisions

The final Chapter of the Agreement sets out the general institutional provisions. It creates a number of bodies responsible for the administration of the agreement, at the apex of which sits the Trade Committee (co-chaired by the Minister of Trade for Korea and the European Commissioner for Trade).

It should be noted that the FTA, is, pursuant to Article 15.14, "an integral part of the overall bilateral relations as governed by the Framework Agreement. It constitutes a specific Agreement giving effect to the trade provisions within the meaning of the Framework Agreement." This reflects the language of Article 43

[14]See Document TN/MA/W/88 of 23 July 2007, "Non-tariff barriers – Proposal on Procedures for the Facilitation of Solutions to NTBs", proposed by the African Group, Canada, the European Communities, the LDC Group, the NAMA-11 Group of Countries, New Zealand, Norway, Pakistan and Switzerland.

(3) of the Framework Agreement between the EU and Korea.[15] The references to the Joint Committee in chapter 15 are in fact references to the Joint Committee of the Framework Agreement, which is the ultimate decision-making body therein. The reference in 15.14 and the language of Article 43(3) of the Framework Agreement permit the suspension of elements of the EU-Korea FTA when "appropriate measures" are to be taken pursuant to Articles 45(3) and (4) of the Framework Agreement where either Party has failed to fulfil its obligations under the Framework Agreement. This is specified in the second paragraph of the Joint Interpretative Declaration concerning Articles 45 and 46 attached to the Framework Agreement which refers to the possibility of appropriate measures to include "specific agreements falling under the common institutional framework". Article 45(4) permits the suspension in cases of special urgency (i.e. without prior consultation) which are defined as either "repudiation of the Framework Agreement not sanctioned by international law or a particularly serious and substantial violation of an essential element of the agreement". Essential elements of the Framework Agreement include democratic principles, human rights and fundamental freedoms and the rule of law (Article 1) and countering the proliferation of weapons of mass destruction (Article 4). This linkage, even if quite complex, means that the EU-Korea FTA is not isolated from the broader relationship between the EU and Korea and provides the legal mechanism by which the FTA would be affected if there were to be a serious deterioration in the bilateral relationship.

The Agreement will enter into force upon the completion of all ratification procedures. As regards the EU, because the Agreement contains some elements of Member State competence, it will require ratification according to the EU system of signature and conclusion and the individual ratification requirements of the Member States. This typically takes a number of years. For that reason, the Agreement makes provision for the provisional application of the agreement. This will be done on the basis of an exchange of notifications which will identify those parts of the Agreement which cannot be provisionally applied. Although the Agreement could be provisionally applied immediately after signature (authorised by the Council) it is likely that provisional application only takes place after the European Parliament has given its views on the agreement.

Conclusion

The EU-Korea FTA marks an important milestone in the development of the EU's policy on RTAs. It sets an important precedent from a number of perspectives.

[15]See Commission proposal for a Council Decision on the signing on behalf of the European Community and provisional application of the Framework Agreement between the European Community and its Member States, of the one part, and the Republic of Korea, of the other part (COM(2009) 631 final) of 18 November 2009.

First, it is the first major RTA to be brought forward for ratification after the entry into force of the Lisbon Treaty has brought about a fundamental re-alignment of the institutional dynamic in the EU on trade policy-making. The agreement will be a first test of the new system, watched closely by all observers of EU trade policy, and the approach taken will set precedents for future agreements.

Second, it is the first major agreement stemming from the Global Europe Strategy where the EU sought to negotiate agreements with the newly emerging highly dynamic countries, particularly in Asia. This focuses the debate on the agreement on economic issues. Does the agreement bring such commercial advantages for the EU as to counterbalance the preferential access given to a highly competitive emerging economy? This is a departure from previous trade agreements, where the debate has often been on the broader foreign or development policy goals associated with the conclusion of an international agreement. Whether the EU-Korea FTA will be unique in this sense remains to be seen. The final stages of the negotiations and the move towards ratification have been accompanied by a renewed interest in some of Korea's regional competitors to also seek an FTA with the EU.

Third, and arguably most importantly, the agreement sets a high standard for what the EU will seek in its FTAs. The EU-Korea FTA is particularly striking for the attention paid to behind-the-border regulatory issues. The important sectoral annexes for trade in goods, and the sectoral rules in the services sector are evidence of this focus. As such, the EU-Korea FTA is perhaps a precursor of an increased focus on the importance of regulatory issues for the achievement of effective market access in trade negotiations. Such a focus can be found in some of the work on non-agricultural market access ("NAMA") in the Doha Development Agenda process, which was in part being discussed in parallel with the EU-Korea FTA. Again, the extent to which this focus is maintained in future agreements will be a matter of great interest to observers of EU trade policy, and international trade policy more generally.

MENA: The Question of Palestinian Observership and Accession to the WTO

Tomer Broude

Introduction

With the multilateral negotiations in the Doha Round in a state of suspended animation, the WTO continues to fulfill its fundamental roles in two main areas: the ongoing work of the dispute settlement system,[1] and the accession of new Members. In the latter area, the past year has seen some progress with respect to the accession of Arab states. In addition, an overture towards future accession has been made by the Palestinians, in a formal request for WTO observership. At the same time, developments in intra-regional economic integration in the Middle East and North Africa (MENA) region have not been significant, in comparison to the state of affairs set out in the previous issue of the EYIEL.[2] It therefore seems appropriate to focus in the current issue on questions related to Arab participation in the multilateral trading system.

This article will provide additional details with respect to these developments and will evaluate several legal and political aspects of the Palestinian request for observership. In general, from a strictly legal perspective the Palestinian Authority (PA) as established by the Israeli-Palestinian accords of the 1990s, did not clearly satisfy the formal criteria for candidacy for WTO Membership, contrary to the advocacy position expressed in the Palestinian request. However, developments in Israeli-Palestinian legal relations, the subsequent practice of both Israel and Palestinians in a number of areas, and developments on the ground may have

The cutoff date for the survey in this article is May 10, 2010.

[1]For a current survey, see WTO, WT/AB/13, Appellate Body – Annual Report for 2009, 17 February 2010.

[2]See Broude, Regional Economic Integration in the Middle East and North Africa: A Primer, EYIEL 1 (2010), p. 269.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_13, © Springer-Verlag Berlin Heidelberg 2011

improved the Palestinian position in this respect.[3] The uncertainty involved, combined with the political sensitivity of the issue could bear negatively on the request for observer status, and objections to the request expressed by Israel and doubts raised by others are therefore justifiable. However, the question of observership allows the General Council significant discretion and does not necessarily require full conformity with the conditions for applying for accession. A pragmatic application of this discretion, supported by the political will of the WTO Membership could overcome the formal difficulties. Indeed, Israel would do well to support Palestinian observership on this basis, for a number of reasons – not least of which is the potential benefit to Palestinian development and constructive Israeli-Palestinian relations.

MENA Context: The State of Play of Arab Accessions

As of this writing, there are 30 states engaged in WTO accession procedures. Six of these are MENA countries. Indeed, Russia and Belarus aside, the population of current candidate states is overwhelmingly Arab and Islamic. Furthermore, the regimes of many of these states are not models of stable democratic governance. WTO accession in these cases therefore holds irregular geopolitical significance.

How have these accession procedures progressed recently? A revised draft Working Party Report was reportedly circulated with respect to Lebanon's accession in October, 2009.[4] A revised draft Working Party Report was distributed with respect to Yemen in December, 2009.[5] And on May 4, 2010, the General Council approved the establishment of a Working Party to examine the Membership request of Syria,[6] that had been submitted almost 9 years earlier.[7] This approval would not have been possible without the consent of the US, and presents a positive political

[3]I addressed the issue of Palestinian accession on a formal, preliminary basis well in the past (see Broude, Accession to the WTO: Current Issues in the Arab World, JWT 32 (1998) 6, pp. 147, 161 et seq.). In the ensuing years, we have witnessed, *inter alia*, the unfortunate collapse of the Oslo process followed by the second Palestinian Intifadah and an Israeli clamp-down in the West Bank, Israeli disengagement from Gaza, inter-Palestinian strife between Fatah and Hamas, and a subsequent full-blown Israeli incursion into Gaza in 2008. These events, and the legal and economic developments that accompanied them, have inevitably had some effect on the analysis of the question of prospective Palestinian WTO Membership.

[4]See http://www.wto.org/english/thewto_e/acc_e/a1_liban_e.htm; the documents are unavailable on the WTO website, as of this writing.

[5]See http://www.wto.org/english/thewto_e/acc_e/a1_yemen_e.htm.

[6]See http://www.wto.org/english/news_e/news10_e/gc_04may10_e.htm.

[7]See WTO, WT/ACC/SYR/1, Accession of the Syrian Arab Republic – Request for Accession Pursuant to Article XII, 30 October 2001.

signal to Syria, who has been designated a "State Sponsor of Terrorism" by the State Department since December 29, 1979,[8] and subject to export sanctions since 2004, under the 2003 Syria Accountability and Lebanese Sovereignty Restoration Act.[9] Indeed, the approval of Syria's WTO Observership came only 2 days after a March, 2010, sensitive report by the State Department Inspector General on the US Embassy in Damascus was made publicly available, including findings that "there is no front-channel guidance" on US sanctions against Syria, with sanctions policies appearing "contradictory" and "inadequate" and a recommendation to conduct inter-agency review of sanctions policy.[10] Reflecting the tradition of pragmatism and relative depoliticization in the GATT/WTO, Syria's embarkation on the path towards accession was not opposed by Israel, who may ultimately request to participate in the Syrian accession Working Party.[11]

Beyond these matters, no meaningful progress has been made in the accession process of other Arab countries (Algeria, Iraq, Libya and Sudan). At the December, 2009 Geneva Ministerial Conference some criticism was voiced by the LDC Group and the Africa Group (the latter coordinated by the Egyptian Delegate to the WTO, H.E. Hisham Badr), with respect to the slow pace of accessions, with implicit reference to obstacles raised to Arab states.[12] However, accession is a process of negotiation, not of simple qualification, and so inevitably the incidence of interests of the incumbent members and the acceding Member will determine the pace.[13] In addition, the speed of the accession process may also depend on the responsiveness of the candidate Member, e.g., Libya has not yet submitted the required Memorandum on its Foreign Trade Regime, almost 6 years after the establishment of an accession Working Party.[14]

[8]See U.S. Department of State, Office of the Coordinator for Counterterrorism, Country Reports on Terrorism, 30 April 2009, Ch. 3, available at http://www.state.gov/s/ct/rls/crt/2008/122436.htm.

[9]Pub. L. 108–175.

[10]See US Department of State and the Broadcasting Board of Governors, Office of the Inspector General, Report of Inspection – Embassy Damascus, Syria, ISP-I-10-34A, March 2010, available at http://oig.state.gov/documents/organization/141119.pdf, p. 16.

[11]Israel has in the past participated in accession Working Party's of Arab states with which it did not have diplomatic relations; for a description of Israel's role in Egypt's accession in the 1960s see Reich, The Threat of Politicization of the WTO, University of Pennsylvania Journal of International Economic Law 26 (2005) 4, pp. 779 et seq. (789–791).

[12]See Agazzi, Trade: Development More Important than Quick Conclusion of Doha, Interpress Service News Agency, 3 December 2009, available at http://ipsnews.net/text/news.asp?idnews=49527, quoting H.E. Ali Mchoumo, Ambassador of Tanzania, as saying that "Rather than being a smooth and fast process, some of the countries have to spend a lot of time on it. One country has spent eight years and the reasons advanced were of a political nature".

[13]On the accession process see Parenti, Accession to the WTO, Legal Issues of Economic Integration 27 (2000) 2, pp. 141 et seq. (150–155); on the increasing duration of accession procedures, and the reasons for it, see Jones, The Political Economy of WTO Accession: The Unfinished Business of Universal Membership, World Trade Review 8 (2009) 2, pp. 279 et seq.

[14]See http://www.wto.org/english/thewto_e/acc_e/a1_libyan_arab_jamahiriya_e.htm.

The Palestinian Observership Request: The Political and Institutional Environment

In this context, a recent development of particular interest, both political and legal, is the request for observer status submitted in October, 2009, by the Permanent Observer Mission of Palestine to the United Nations and Other International Organizations,[15] to the WTO General Council.[16] The Palestinian request was resubmitted in April, 2010, with the hope of being approved at the May 2010 meeting of the General Council.[17] However, the request was not included in the agenda meeting, postponing discussion to future meetings. The original request for observership was soon followed by a Palestinian submission (reportedly prepared by a consultancy based in Switzerland) that makes the legal case for Palestinian eligibility for observer status (the "Palestinian Opinion").[18]

The Palestinian request can be understood as a component of the Palestinian state- and institution-building process currently being led by PA Prime Minister, Salam Fayyad, with a view to being optimally prepared for Palestinian statehood by August, 2011.[19] Observership would enable a Palestinian delegation to attend WTO meetings and engage in a learning process that would improve its prospects for accession at a later stage,[20] including access to technical assistance. As the resubmitted request states:

> This observership comes within the comprehensive plan and vision of state building set forth by Palestinian National Authority. Observership in the WTO is an important requisite to help build the necessary infrastructure of state institutions, provide the premise to review and establish a new comprehensive trade regime in line with rules governing multilateral trade as prescribed by the WTO Agreement, with the aim of encouraging sustainable

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[15] In the UN System, the Permanent Observer Mission of Palestine is classified as a Non-Member State Entity, under the heading of "Other entities having received a standing invitation to participate as observers in the sessions and the work of the General Assembly and are maintaining permanent offices at Headquarters"; see http://www.un.org/en/members/nonmembers.shtml.

[16] See WTO, WT/L/770, Palestine – Request for Observer Status – Communication from Palestine – Application for Observership in the General Council and its Subsidiary Bodies, 6 October 2009. The Palestinians were granted observer status at the 2009 Ministerial Conference in Geneva and at the 2005 Ministerial Conference in Hong Kong. However, such observership does not automatically entail observer status at the General Council, see WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996 (the "MC/GC Rules of Procedure"), Annex 2, Paragraph 2.

[17] See WTO, WT/L/792, Palestine – Request for Observer Status – Communication from Palestine – Application for Observership in the General Council and its Subsidiary Bodies, 13 April 2009.

[18] See WTO, WT/L/770/Add.1, Palestine – Request for Observer Status – Communication from Palestine – Application for Observership in the General Council and its Subsidiary Bodies – Addendum, 23 October 2009.

[19] See Weymouth, "My Preoccupation Now is This Plan", Newsweek, 2 November 2009, available at http://www.newsweek.com/id/219374.

[20] See reference in the Palestinian Opinion to "eventual membership", p. 1.

development throughout Palestine, all of which are key objectives in creating an independent viable state.[21]

This vision of Palestinian observership is in accordance with the accepted connection between observership and prospective WTO Membership, as set out in WTO rules of procedure, according to which "[t]he purpose of observer status in the General Council and its subsidiary bodies is to allow a government to better acquaint itself with the WTO and its activities, and to prepare and initiate negotiations for accession to the WTO Agreement".[22] Moreover, governments requesting observer status must indicate their intention to initiate negotiations over WTO Membership within a "maximum" period of 5 years from attaining observership.[23] Nevertheless, observer status may be extended beyond this 5-year period for governments that did not initiate accession negotiations.[24] Indeed, in most cases, states request observership only upon submission of a request for accession, making the 5 year period a moot issue.

That the motivation for the Palestinian request is technical and professional rather than political is a credible notion. Observership would not be a significant diplomatic factor in a Palestinian bid for statehood, because WTO Membership is in principle open to non-state entities that qualify as "Separate Customs Territories" (SCT), with no implications for claims of sovereignty,[25] and in any case the Palestinians already enjoy observership in other international governmental organizations, with whatever symbolic or other value this may entail.[26] However, Israel and some other Members appear to be concerned that Palestinian observership at the WTO will be colored by the politicization that has been characteristic of Palestinian participation in other international organizations over the years, on the backdrop of the continued Israeli-Palestinian conflict. The Palestinian resubmitted request is sensitive to this concern in its statement that it "is a technical application,

[21] WTO, WT/L/792, Palestine – Request for Observer Status – Communication from Palestine – Application for Observership in the General Council and its Subsidiary Bodies, 13 April 2009, p. 1.

[22] See WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996, Annex 2, Paragraph 3.

[23] WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996, Paragraph 4.

[24] See WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996, Annex 2, Paragraph 4, 1st sentence, and Paragraph 8.

[25] See, e.g., WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996 fn. 1: "It is understood that in the case of a separate customs territory Member the credentials of its representatives shall have no implication as to sovereignty".

[26] Palestine has been granted observer or similar affiliated status to various intergovernmental organizations, *inter alia* the World Tourism Organization, UN Educational, Scientific and Cultural Organization, and the International Labour Organization.

not a political action".[27] Nevertheless, the tendency toward politicization was evident in the same period, with the Palestinians making a diplomatic effort to prevent Israel's acceptance as a full member of the Organization for Economic Cooperation and Development (OECD) in early May, 2010.[28] Furthermore, the Israeli government is, as of this writing, reluctant to make diplomatic 'concessions' towards the Palestinians,[29] beyond some agreement to participate in 'proximity talks' that might lead to engagement in direct renegotiations. Thus, Israeli consent to Palestinian observership does not come naturally in the current diplomatic climate.

Are the Conditions for Observership the Same as the Criteria for Accession? The Discretion of the General Council

One preliminary question that arises here, that in my view is not adequately addressed in the Palestinian request, is whether a government requesting *observer* status must at the time of the request or at the time of the approval of its observership satisfy the formal eligibility criteria for *Membership* under Article XII WTO, namely, that it is a "State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for" in the WTO Agreements. At first glance, this would seem to be the case; a government that lacks the eligibility to submit an accession request under Article XII WTO would not be in a position to assure the General Council of its intention to submit such a request within 5 years, unless it were for some reason – such as an agreed plan of state-formation and independence – confident that it would become a state or SCT within that timeframe. However, the rules of procedure only require an intent to initiate accession talks, and not an assurance; if accession talks are not initiated within the 5-year period, because the government in question is ineligible for an application for Membership, the observership may simply lapse, or be extended further.

[27]WTO, WT/L/792, Palestine – Request for Observer Status – Communication from Palestine – Application for Observership in the General Council and its Subsidiary Bodies, 13 April 2009, p. 1.

[28]See Toth Stub, OECD Accepts Israel as Member, Wall Street Journal, 10 May 2010, available at http://online.wsj.com/article/SB10001424052748703880304575235910940084780.html?mod=WSJ_latestheadlines. Reportedly, "the PA's Minister of Foreign Affairs Riyad al-Maliki sent letters to OECD leaders and foreign ministers of member countries, asking them not to approve Israel's entry. Doing so would legitimize Israel's "dangerous," "illegal," and "racist" policies toward Palestinian residents of the West Bank and East Jerusalem, Mr. Maliki wrote". It is not difficult to see how such moves would not be conducive to Israeli consent to Palestinian WTO observership.

[29]See Shabi, Avigdor Lieberman Rules Out "Concessions" to Palestinians, Guardian, 1 April 2009, available at http://www.guardian.co.uk/world/2009/apr/01/israel-palestinians-lieberman-annapolis.

Furthermore, there are formal indications that qualifications relating to Membership can be relaxed when what is at stake is merely observer status. The relevant rules of procedure establish the possibility that observership will be granted to "[r]epresentatives of States or separate customs territories", omitting the requirement of "full autonomy" that appears in Article XII WTO in relation to Membership.[30] Arguably the reference to States and SCTs in this provision of the General Council rules was simply intended to distinguish between such governmental observers, even of diminished capacity (i.e., possessed of less than full autonomy), on one hand, and the separate case of observer status granted to *intergovernmental* organizations, on the other hand, that are by nature not associated with a particular territorial customs jurisdiction.[31]

Moreover, in deciding upon requests for accession negotiations proper, "the margin of discretion of the [General] Council seems to be rather limited", so that it may reject an application only if the applicant is neither a state nor an SCT.[32] In contrast, decisions on observership are to be made on a "case-by-case basis".[33] On one hand, this suggests that the General Council may, at its discretion, reject requests for observer status even if submitted by governments that are formally eligible to submit a full accession request, even if they are States. On the other hand, and this is the crucial point in the present context, this implies that the General Council has leeway towards accepting requests for observer status from governments that don't fully qualify for – or are uninterested in[34] – full accession procedures. In any case, the procedures for observership are part of the General Council Rules of Procedure, which may at anytime be amended by the General Council, implying that the ad hoc derogations are also permissible, if approved by the General Council.[35]

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[30] WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996, Rule 10.

[31] WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996, Rule 11.

[32] According to Parenti, Accession to the WTO, Legal Issues of Economic Integration 27 (2000) 2, pp. 141 et seq. (150), "[t]he only possibility that the Council has to reject an application at this stage, and to refuse the establishment of the Working Party, is for it to consider that the applicant is not a State nor a SCT in the sense of Article XII".

[33] WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996, Annex 2, Paragraph 5.

[34] For example, the Vatican (The Holy See) is a permanent Observer to the WTO Ministerial Conference and General Council, although – and indeed because – in its request for observership it stated in no uncertain terms that it is not seeking WTO Membership; this approach was not immediately accepted by some WTO Members. See WTO, WT/L/221, Holy See – Request for Observer Status in the Ministerial Conference and the General Council, 2 July 1997; also WTO, WT/GC/M/21, General Council – Minutes of Meeting held in the Centre William Rappard on 16 July 1997, 6 August 1997.

[35] WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996, Rule 39.

In short, it appears that the General Council has significant discretion in deciding to grant observer status to a government, even if it does not fully satisfy the formal eligibility requirements for applying for accession, particularly the cumulative requirement of "full autonomy".

In spite of this conclusion, it is interesting that the Palestinian Opinion follows a much stricter tack, that explicitly links the question of eligibility for observership to the formal eligibility criteria for applying for accession., an approach that logically requires it to claim that the Palestinian Authority already satisfies the latter. If this were indeed the case, perhaps the Palestinians should have simply applied for accession under Article XII WTO and the relevant procedures, with an invitation to observership flowing naturally as a result. However, as will be explained below, significant doubts may be raised relating to the PA's clear and full fulfillment of the conditions for applying for accession. Practically, it is very unclear whether the PA is currently in any position to engage in serious discussions on accession; and politically, it is doubtful whether either the PA (or various stakeholders in the PA) or Israel could live with the scrutiny of an accession Working Party.

The linkage between Membership criteria and observership is therefore detrimental to the stated goal of Palestinian observer status, and sets Israel in an overly defensive position with respect to the request. It would have perhaps been better for the Palestinian goal of observership to rather emphasize the flexible and discretionary aspect of the decision to grant observer status, making it less contingent upon the issue of eligibility for accession.[36] A similar approach enabled Palestinian participation as a governmental observer at the last two Ministerial Conferences of the WTO, even though such observership, too, is formally available only to States and SCTs.[37] This pragmatic approach would also be more suitable to the special nature of the currently pending request and its particular political circumstances, neutralizing, at least to some extent, concerns of the Membership regarding the possible precedential effect of the requested Palestinian observership on other politically sensitive geopolitical cases, such as Kosovo.[38]

This discussion leads, inevitably to the question of decision-making procedure. In principle, the WTO General Council could approve Palestinian observership

[36]To be sure, the Palestinian Opinion does emphasize the pragmatism of WTO practice (at pp. 8–9), but not in terms of General Council discretion to de-link observership from eligibility for accession; rather, the plea is for pragmatism in the interpretation of eligibility terms for accession.

[37]WTO, WT/L/161, Rules of Procedure for Sessions of the Ministerial Conference and Meetings of the General Council, 25 July 1996, Rule 10. To be sure, one should not derive from observership at the Ministerial Conferences that Palestine has been recognized by the General Council as a State or SCT, but rather that the General Council has adopted a flexible approach to observership that enabled Palestinian observer status without determining whether the PA is indeed an SCT.

[38]As of this writing, Kosovo has not applied for either observership or accession to the WTO; and the question of Kosovo's political status is pending before the ICJ (see ICJ, Request for Advisory Opinion – Accordance with International Law of the Unilateral Declaration of Independence by the Provisional Institutions of Self-Government of Kosovo, 9 October 2008, available at http://www.icj-cij.org/docket/files/141/14799.pdf.

by majority vote.[39] However, in the spirit of Article IX:1 WO, first sentence, the General Council continues the practice of decision-making by consensus. Israeli consent would therefore be expected for the observership request to be approved. Linking observership to the criteria for an accession application means that a decision on observer status may be understood as an *ipso facto* decision on eligibility for accession procedures. Under these terms, Israel may object, formally, that the PA does not fulfill accession criteria, and WTO Members would have to satisfy themselves that this is not the case before deciding on observership. The debate would – and indeed – might become unusually messy (and unattractive to WTO delegates who traditionally avoid politicization of this sort), as the discussion of Palestinian eligibility below demonstrates. In contrast, focusing on the discretion available to the General Council in approving observership, regardless of the fulfillment of prospective accession criteria, would de-politicize the debate and make it simpler, and furthermore force Israel to justify any objections it may raise on non-formal grounds, which may be more difficult, and might cast its position in the same negative light of the politicization that it fears is associable with the Palestinian request.

The Understated Historical Uniqueness of the Palestinian Claim

As explained above, the Palestinian request for observership, as submitted, relies on a claim that the PA fulfils the criteria for applying for accession. This linkage could have been avoided, in a way that might have been more conducive to the prospects of Palestinian participation in the multilateral trading system (so long as the PA is not considered a State, in which case much of the present discussion would be redundant). As a complicating factor, it is important to understand just how unique this Palestinian claim is, in a historical-political perspective. Although the Palestinian Opinion depicts the Palestinian request as if it were a routine one (“Normal Case, Normal Rules: A ‘Separate Customs Territory’ on the Way to Statehood”, as the Palestinian Opinion’s sub-title states), the request is in fact entirely unprecedented.

The request is based on the claim that Palestine, or the Palestinian Authority – the terms are used interchangeably in the Palestinian Opinion, despite the legal differences between them[40] – is a Separate Customs Territory (SCT) eligible for

[39]Observership is not a “decision on accession” that would require Ministerial Conference approval, and certainly not an accession agreement that requires the approval of two-thirds of the Ministerial Conference under Article XII:2 WTO. MC/GC Rules of Procedure make it clear that observership is within the regular decision-making authority of the General Council. See also Parenti, Accession to the WTO, Legal Issues of Economic Integration 27 (2000) 2, pp. 141 et seq. (150).

[40]Unfortunately, the Palestinian Opinion skirts some of the questions relating to the legal capacity of the requesting entity, by using the terms “Palestine” and “the Palestinian National Authority” in alternation, and at times referring only to “the Palestinians” or “the Palestinian side”. The legal

consideration for membership under Article XII WTO, and hence observership should be granted. It does not rest on a claim of statehood, although this possibility is not entirely excluded.[41] The claim is unique in GATT/WTO history, because it has never occurred that a non-state government with only partial autonomy in relation to an external controlling power has asserted independent eligibility for membership, that is unsponsored accession.[42] The few SCTs that had been GATT contracting parties prior to the establishment of the WTO effectively attained this status under the sponsorship of the relevant suzerain. Southern Rhodesia, was in 1948 an original signatory of the Protocol of Provisional Application and a GATT contracting party, as an SCT under the effective sponsorship of the United Kingdom, and remained so until gaining independence as Zimbabwe in 1980.[43] Burma (Myanmar) and Ceylon (Sri Lanka), as SCTs, had signed the Final Act adopted at the conclusion of the Second Session of the Preparatory Committee of the UN Conference on Trade and Employment, which authenticated the text of the GATT; thus, they are sometimes cited as SCT GATT Contracting Parties. However, ultimately their acceptance of the provisional application of the GATT was completed after gaining independence very soon after the entry into force of the Protocol of Provisional Application (January 4, 1948 in the case of Burma; February 4, 1948, in the case of Ceylon). In the process of their decolonization, many newly independent states gained admission to the GATT under the sponsorship of their former suzerain in accordance with Article XXVI:5(c) GATT. However, the common practice was to request to be deemed a GATT Contracting Party immediately after gaining independence, thus gaining admission to the GATT without the

standing of the Palestine Liberation Organization (PLO), who is in fact the entity that has signed several trade agreements "for the benefit of the Palestinian Authority", is also not addressed in the Palestinian Opinion.

[41]The Palestinian Opinion distinguishes the question of eligibility for WTO observer (and Membership) status, from "other contexts in which statehood might matter" (at p. 2). This can be read, at the least, on the background of the submission by the PA of a "Declaration Recognizing the Jurisdiction of the International Criminal Court", dated 21 January 2009, with reference to Article 12(3) of the Rome Statute Establishing the International Criminal Court (UN Doc. A/CONF. 183/9; 37 ILM 1002 (1998), 2187 UNTS 90) (available at http://www.icc-cpi.int/NR/rdonlyres/74EEE201-0FED-4481-95D4-C8071087102C/279777/20090122PalestinianDeclaration2.pdf). Article 12(3) ICC applies to "a State which is not a Party" to the Statute, and the ICC Prosecutor is currently weighing the capacity of the PA to make such a declaration on this basis. For conflicting views on this issue, see Benoliel/Perry, Israel, Palestine and the ICC, Boston University International Law Journal (2010, forthcoming); Quigley, The Palestine Declaration to the International Criminal Court: The Statehood Issue, Rutgers Law Record 35 (2009), p. 1.

[42]The GATT 1947 included two mechanisms for SCTs to gain Contracting Party status – either through sponsorship under Article XXVI:5(c) GATT or through independent, non-sponsored accession under Article XXXIII GATT. The possibility of sponsored admission has no corollary in the WTO; the only option is unsponsored accession under Article XII WTO.

[43]Southern Rhodesia (Zimbabwe) is, however, hardly a positive historical example of SCT participation in the GATT/WTO system and smooth transition from SCT to State; Zimbabwe did not have a permanent mission to the GATT until 6 years after it became independent (see Hess, Zimbabwe Case Study on Trade Negotiations, ODI Working Paper, October 2001, available at http://www.odi.org.uk/resources/download/3616-working-paper.pdf, p. 29).

complication of accession negotiations.[44] In other words, admission was granted to States, not to SCTs. Article XXVI:5(c) GATT therefore became a convenient conduit for facilitating succession of rights and obligations under GATT between colonial powers and new States.[45] In a different era, and under different circumstances, Hong Kong and Macao, both of whom acceded to the GATT as SCTs in accordance with the procedure of Article XXVI:5(c) GATT, did so under the sponsorship of the United Kingdom and Portugal, respectively, as suzerains. The Principality of Liechtenstein also acceded to the GATT with the sponsorship of Switzerland under Article XXVI:5(c) GATT, although it was an independent State at the time, in order to benefit from the quick and simple process of admission through sponsorship, before that avenue was closed with the establishment of the WTO.[46]

No SCT ever acceded to the GATT without sponsorship, under the alternative offered by Article XXXIII GATT. The only such SCT to apply for GATT accession under that provision subsequently acceded to the WTO under the successor Article XII WTO. The SCT in question was the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu (Chinese Taipei), whose accession was approved in 2001.[47] While the international political and legal status of Chinese Taipei is controversial,[48] its autonomy in international economic policy-making and de facto independence from the People's Republic of China is manifest. Chinese Taipei was therefore in a position in which it had no suzerain or other power restricting its autonomy.

In other words, in these few earlier cases of SCT accession, the formal eligibility of the government in question for admission was not in doubt, either because of the declaration of sponsorship of a relevant suzerain, or because of the absence of a controlling power. In the Palestinian case, sponsorship is no longer an option, because no procedure similar to Article XXVI:5(c) GATT was included in the WTO, and the PA is in many respects subject to the control of Israel as an external power, because of *de jure* restrictions on its legal capacity, as well as the high degree of *de facto* control exerted by Israel with respect to areas otherwise within PA jurisdiction. Furthermore, while the PA may indeed be "on the way to Statehood" and a "State in the Making", as noted in the Palestinian Opinion,[49] the history of SCT accession demonstrates that this is not necessarily the "normal case", to the extent that there could be said to be one. Existing SCT WTO Members have either

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[44]See, e.g., GATT, W. 18/3, Admission of Sierra Leone as a Contracting Party, 17 May 1961.

[45]See Kunugi, State Succession in the Framework of GATT, AJIL 59 (1968), pp. 268 et seq.

[46]See GATT/1626, Liechtenstein becomes 120th Member of the GATT, 31 March 1994, available at http://www.wto.org/gatt_docs/English/SULPDF/91770052.pdf.

[47]See WTO, WT/MIN(01)/4, Ministerial Conference, Fourth Session – Report of the Working Party on the Accession of the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, 11 November 2001.

[48]See Henckaerts (ed.), *The International Status of Taiwan in the New World Order: Legal and Political Considerations*, 1996; Crawford, *The Creation of States in International Law*, 2006, pp. 196–221.

[49]At p. 1 and 9, respectively.

became an administrative part of another State (as in the cases of Hong Kong and Macao), or continue to maintain a *sui generis* international legal status (as in the case of Chinese Taipei).[50] Looking forward, these are hardly models that the Palestinian pitch for observership would find attractive.

Legal Critique of the Palestinian Claim for Eligibility for Accession

So long as the PA or Palestine are not to be considered as a State, eligibility for an application for WTO Membership must be assessed according to the objective criteria of Article XII WTO. There are two such criteria, and they are distinct and cumulative. The first is that the PA is territorially a SCT, namely, a territory "with respect to which separate tariffs and regulations of commerce are maintained for a substantial part of the trade of such territory with other territories".[51] The second condition is that the "PA possesses full autonomy in the conduct of its external commercial relations and of the other matters provided for" in the WTO Agreements. As noted above, fulfillment of both these conditions, particularly the second condition of "full autonomy", is not necessarily required for observership, but the Palestinian request makes the claim and relies on it nevertheless, and although an exhaustive discussion is not possible in the scope of this article, a few words might be said on the merits of the Palestinian claim.

Is the PA a Separate Customs Territory?

The Palestinian Opinion does not devote much attention to the first condition, focusing instead on the second condition of "full autonomy". The definition of an SCT is indeed difficult to determine precisely.[52] Article XXIV:2 GATT defines a customs territory as "any territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territories with other territories". Clearly, this does not mean that States engaged in a Customs Union are no longer customs territories, as suggested *ad absurdum* in the Palestinian Opinion,[53] merely because the have harmonized their external tariff

[50]This is in fact acknowledged in the Palestinian Opinion, p. 9.

[51]See Palestinian Opinion, p. 3, with reference to Article XXIV:2 GATT.

[52]See discussion in Broude, Accession to the WTO: Current Issues in the Arab World, JWT 32 (1998) 6, pp. 147, 159–160; and Parenti, Accession to the WTO, Legal Issues of Economic Integration 27 (2000) 2, pp. 141 et seq. (146–147).

[53]See Palestinian Opinion, p. 2: "No government would accept [. . .] that autonomy as understood by WTO rules for purposes of status and eligibility is relinquished upon the entry into bilateral trade agreements".

systems. Rather, they remain independent States, each with its own national customs administration. However, States do not bear the burden of demonstrating that they are customs territories, and separate customs territories at that, whereas non-state governments do.[54] The issue of "separateness" relates to the territorial dimension, not to the issue of authority, which is rather covered by the second condition of "full autonomy". Separateness goes back to the original structure of the GATT 1947 in the waning days of colonialism, in which Contracting Parties, in the Protocol of Provisional Application, undertook to make effective the application of the GATT not only in their own "metropolitan territory" proper, but also in respect to "any of their territories",[55] i.e., territories of their colonies which were deemed to be separate in their territorial administration of tariffs and other regulations of commerce, but lacked full autonomy, being in the control of a colonial government. To be sure, 'separate customs' does not necessarily mean 'different tariffs'. The tariff schedule of an associated (and unseparate) territory might be identical to that of its controlling counterpart, and yet they might be considered separate from each other. The question is whether goods entering the associated territory are subject to a separate territorial administration of tariffs or not, even if the tariff rate is the same.

Applying this to the case of Israel and the PA, the Palestinian territories are not part of Israel's metropolitan area for the purposes of the GATT/WTO. This does not, however, mean that they are separate in the sense of Article XII. The economic arrangement between Israel and the PA under the Paris Protocol[56] is similar to a customs union, but its overall external tariff is determined by Israel, with few exceptions. If the PA were a State, as already noted, the customs union would indeed not impair the independence of its potential status under the GATT/WTO (as in the case of Liechtenstein and Switzerland). As a non-State government, however, this is not as simple to say. This is especially problematic because the tariffs and other commercial regulations of most of the Palestinian trade with other territories are administered by Israel, including collection of duties.

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[54]See discussion, unrelated to the PA, in Parenti, Accession to the WTO, Legal Issues of Economic Integration 27 (2000) 2, pp. 141 et seq. (145–146); Parenti discards the argument that the "full autonomy" criterion applies to States, with specific reference to States that are in customs union arrangements with WTO Members at the time of the request for accession, but establishes in contrast that among non-State SCTs, only those in possession of "full autonomy" may be considered for accession.

[55]See Article 2, Protocol of Provisional Application (PPA), T.I.A.S. 1700, 55 U.N.T.S. 308PPA, 30 October 1947.

[56]The Paris Protocol is the Protocol on Economic Relations between the Government of Israel and the PLO representing the Palestinian People, done at Paris on 29 April 1994. It was included as an annex to the Israel-PLO Agreement on the Gaza Strip and the Jericho Area, 4 May 1994, 33 I.L.M. 622 (1994) and subsequently partially incorporated and expanded upon in the Agreement on Preparatory Transfer of Powers and Responsibilities, 29 Aug. 1994, 34 I.L.M. 455 (1995). It was ultimately added as Annex V of the Israel-PLO Interim Agreement on the West Bank and the Gaza Strip, 28 Sept. 1995, 36 I.L.M. 551 (1997). For early analyses of these arrangements see Kleiman, The Economic Provisions of the Agreement between Israel and the PLO, Israel Law Review 28 (1994), p. 347; and Elmusa/El-Jaafari, Power and Trade: The Israeli-Palestinian Economic Protocol, Journal of Palestine Studies 24 (1995) 2, p. 14.

The structure of the original Paris arrangement between Israel and the PA was of a highly integrated economic unit, with separate administration constituting the exception rather than the rule.[57] Subsequent practice has, however, for the detriment of both parties, seen the Palestinian territories gradually separated from the Israeli economy. The movement of goods between Israel and the Palestinian territories, in both directions, is highly regulated by Israel. Israel has even made representations that depict Palestine as a separate territory for the purpose of applying safeguards, for example.[58] The assertion that the PA is an SCT satisfying the first condition for applying for accession is therefore plausible under current *de facto* conditions,[59] even if this was not the case under the original formal architecture of the Israeli-Palestinian economic arrangements.

However, in sum, whether the PA constitutes a SCT for the purpose of Article XII WTO is a question that cannot be objectively answered without hesitation and some qualification, given the original structure of economic association between Israel and the PA, as well as the fluid nature of Israeli-Palestinian economic arrangements.

Does the PA Possess the Requisite "Full Autonomy"?

The main difficulty in the Palestinian request is not the PAs territorial status as an SCT, but rather its assertion of "full autonomy". Arguably, in this respect the original structure established by the Paris Protocol has not been altered by subsequent developments and practices over the years, and the preliminary analysis holds: "it vests practically all authority for external commercial affairs in the Israeli government".[60] This is especially true in the area of tariffs, which is the most fundamental field for establishing full autonomy.[61]

[57]The strongest element of separateness can be seen in Article III:15 of the Paris Protocol, according to which "The clearance of revenues from all import taxes and levies, between Israel and the Palestinian Authority, will be based on the principle of the place of final destination". This provision is not referred to in the Palestinian Opinion, but strongly suggests a distinction in the tariff treatment of the territories of Israel and the territory controlled by the Palestinian Authority.

[58]See e.g. WTO, G/SG/N/7/ISR/1, Notification under Article 12.4 of the Agreement on Safeguards – Israel – Steel Rebars, 26 June 2009, p. 7, listing by Israel of Palestine as a developing country to which a provisional safeguard measure does not apply.

[59]The Palestinian Opinion, in contrast, eschews the relevance of *de facto* limitations for the analysis of eligibility for observership (at p. 6); the conditions on the ground enhance the PA's status as an SCT, but impair its full autonomy. As argued above, full autonomy is not required for observership, subject to the General Council's discretion.

[60]See Broude, Accession to the WTO: Current Issues in the Arab World, JWT 32 (1998) 6, pp. 147, 162.

[61]See Parenti, Accession to the WTO, Legal Issues of Economic Integration 27 (2000) 2, pp. 141, 146: "an SCT that does not cover tariffs will likely fail the test of autonomy of external commercial relations".

The Palestinian Opinion erroneously depicts the Israeli-Palestinian relationship in this regard as one of symmetry, in which the parties have agreed to "largely align their policies", as in a regular customs union.[62] However, this is hardly the case. First, the Palestinian Opinion refers to the "very fact that the Israeli and Palestinian sides possessed the legal capacity to enter into [the Paris Protocol] demonstrates their autonomy to regulate trade".[63] This includes a few leaps of faith. The Paris Protocol was not entered into by the PA, but rather by the PLO, Representing the Palestinian people. Under the Paris Protocol, the PA has only those authorities and competences in the field of import policy that were explicitly granted to it therein. The PA, as a legal person, is very much a creation of the Oslo Accords, with limited authority. Thus, the Paris arrangement is not one of reciprocal concessions between two equally empowered parties. Rather, it is a delegation or conferral of authority to the PA, a non-State government with enumerated powers, by Israel, a State acting *inter alia* as a belligerent occupant; residual authority therefore remains with Israel so long as it maintains that status and the related agreements remain in force.[64] Second, the import policy alignment is a one-way street, in which Israel did not relinquish any of its own pre-existing autonomy, as would have been the case in a reciprocal customs union (and in any case, as a State, the "full autonomy" of Israel is not at issue). Third, along these lines, the PA is required to follow Israeli tariff policy, with limited exceptions.

Indeed, this asymmetry significantly limits the ability of the PA to make any external trade commitments that stray from those made by Israel. The Palestinian Opinion points out that the PA may impose higher tariffs, in accordance with Article III:5(a) Paris Protocol, and explains that it is the ability to bind tariffs to upper limits that is of interest to WTO law.[65] This is somewhat confusing, as it implies that if the PA had been granted the authority to apply only *lower* tariffs than those imposed by Israel, then this would have had no interest to the Multilateral trading system, and this is simply not the case. In any case, this hardly makes for "full" autonomy. The PA cannot commit to discipline tariffs on imports to its territory at a rate that is lower than the rate applied by Israel, and therefore cannot effectively participate in tariff negotiations. This obstacle is clear from a regional situation: in the GAFTA,[66] the PA has been exempted from tariff reductions "due to its geopolitical situation",[67] clearly with reference to its inability to implement

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[62]Palestinian Opinion, p. 5.

[63]See Palestinian Opinion, p. 4.

[64]See in particular Article I:1 Israel-PLO Interim Agreement on the West Bank and the Gaza Strip, 28 Sept. 1995, 36 I.L.M. 551 (1997), according to which any power anything not expressly transferred to the PA remains in Israeli authority.

[65]See Palestinian Opinion, p. 5.

[66]The Greater Arab Free Trade Agreement, created in 2005. On GAFTA see Broude, Regional Economic Integration in the Middle East and North Africa: A Primer, EYIEL 1 (2010), p. 269.

[67]See Syria, Ministry of Agriculture and Agrarian Reform, National Agricultural Policy Center, working Paper No. 8, Implementation of the Great Arab Free Trade Area Agreement: The Case of Syria (undated), www.napcsyr.org/dwnld-files/working_papers/en/08_gafta_en.pdf.

tariff reductions without Israel's consent. This is in comparison to a series of trade agreements signed by the PLO on behalf of the PA, some of which are structured as regular reciprocal free trade agreements – but in fact rely to large extent on the pre-existence of similar free trade agreements with Israel. Furthermore, to take a counterfactual example, if Israel were to violate its WTO obligations under Article II GATT by applying tariffs higher than its tariff bindings, the PA would have no choice but to follow suit. Its autonomy to prevent its own violation is therefore limited.

The Palestinian Opinion later enumerates several areas of commercial regulation in which the PA ostensibly has full autonomy; these are important factors, but it is not entirely clear that they support the Palestinian request. For example, on one hand, the PA is not limited in its capacity to use trade remedies; on the other hand, this is not entirely the case: the PA must follow trade remedies imposed by Israel, if the latter so decides, as part of its import policy. With respect to quantitative restrictions, it is argued that the PA is not precluded from applying import bans or quotas on third-party imports or exports. The Palestinian Opinion understates some of the indirect restrictions that apply to the PA's ability to make services liberalization commitments. In the field of intellectual property protection, the PA has indeed been granted the authority to promulgate internal legislation, but would not, for example, be in a position to prevent stringent border measures taken by Israel against goods in either export or import, that the PA did not consider to be infringing.

Conclusions

The Palestinian Opinion makes a forceful case for the claim that the PA fulfills the criteria for applying to begin an accession process. This view is undertaken in order to promote the Palestinian bid for observer status at the WTO. Nevertheless, as we have seen in the previous section, various legal and other issues cast at the very least, a shadow of doubt on the Palestinian claim.

However, in constructing their request for observership, the Palestinians made a crucial choice: they decided to base their request upon the claim that the PA already fulfils the objective criteria for WTO accession. This significantly ups the diplomatic ante involved, because it essentially means that a decision to grant the PA observership, is tantamount to a decision on accession. It also links the request to relatively stringent criteria, upon which formal objections can be raised by anyone opposed to Palestinian participation.

A different approach could have been pursued, whereby observership were explicitly de-linked from prospective future accession, building instead on the broad discretion available to the WTO General Council in this regard. In this approach, formal objections to Palestinian participation (by Israel, for example) would certainly fail, and political objections would be scorned.

To be sure, in considering whether the PA fulfills the criteria for accession, Israel's objections should be the last to be heard. If the PA does not fully qualify for a WTO Membership application, this is primarily because of Israel's continued formal and effective control over the territories it has occupied since 1967, and because of the asymmetrical institutional structure of the preferential trade arrangements between Israel and the Palestinians. Somewhat counter-intuitively, in the WTO, these are precisely the reasons that should diminish the political and persuasive weight of any objections raised by Israel in this case. Of all WTO Members, Israel needs the least assurance that the PA holds the legal and practical capacity to respect external trade liberalization commitments, as required of a new or prospective WTO Member. Overall, this issue demonstrates the tension between the legal and the pragmatic in the WTO. Given the stakes involved, one hopes that in this case, pragmatism will prevail.

Integration and Disintegration in North America: The Rise and Fall of International Economic Law in One Region

Stephen Clarkson

Introduction [1]

The jurisprudential significance of North America as far as regional economic integration is concerned depends in the first place on what we take North America to be. The general use of the term "North America" in Europe and Latin America as a synonym for the United States of America is unhelpful since this connotation reduces the region to one – albeit giant – national economy. For Canadians, "North America" has generally meant the entity comprised of Canada and mainland USA. Of obsessive interest to Canadians and negligible interest to Americans, this dyad generated little of interest in international economic law until the Canada–United States Free Trade Agreement (CUFTA), which entered into force on January 1, 1989, constitutionalized a by then closely allied, highly integrated, and culturally complementary dyad.

If we want to think about North America as a region generating its own international economic law, we have little choice but to narrow the notion chronologically to the last 20 years and define it juridically to mean the three-state political-economy zone that was created on January 1, 1994 when the North America Free Trade Agreement entered into force and brought Third-World Mexico (90 million population, $421 billion GDP, $7,100 per capita income) into a formalized economic treaty relationship with the world's first (263 million population, $7,020 billion GDP, $26,230 per capita income) and seventh largest (29 million population, $564 billion GDP, $21,050 per capita income) capitalist powers. [2]

[1] This text borrows from the research incorporated in *Does North America Exist? Governing the Continent after NAFTA and 9/11*, 2008 and from the summary chapter written for Enderlein/Wälti/Zürn (eds.), *Handbook on Multilevel Governance*, 2010.

[2] Gross National Income per capita is in Purchasing Power Parity in current international dollars; all data come from World Bank Group, 2009. World Development Indicators Database. Available online at: http://ddp-ext.worldbank.org/ext/DDPQQ/member.do?method=getMembers&userid=1&queryId=135 (last accessed: 25 January 2010).

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_14, © Springer-Verlag Berlin Heidelberg 2011

To understand recent developments in this recently constructed North America in terms of this yearbook's concerns, we need first to remind ourselves that NAFTA did not herald a marriage made in heaven for the quite disparate bilateral relationships that the United States enjoyed with its two geographical neighbours. For over a century and a half, the processes of transborder trade and investment between the United States and Canada had made the latter a virtual economic satellite of the former.[3]

Following the Americans' military conquest of half Mexico's territory in the 1840s, similar processes of trade and investment integration between the United States and Mexico during the rest of the nineteenth century had been interrupted by the Mexican revolution of 1910. Mexico's revolutionary break with the United States was legally entrenched in its 1917 constitution, deepened by its 1938 nationalization of the Mexican oil industry, and operationalized for three decades following World War II by its concerted import-substitution-industrialization strategy aimed at developing the national economy under the tutelage of its authoritarian, single-party government and in isolation from its distrusted and feared northern neighbour.

Mexico's governing autocracy carried out a self-generated counter revolution in the 1980s by adopting neo-conservatism's nostrums of minimal-state laissez-faire and trade and investment liberalization. Its objective became integration with, rather than isolation from, the United States. Mexico joined the OECD and the GATT, privatized large numbers of its state-owned corporations, and liberalized its legal regime for competition and foreign investment – an apertura that established the preconditions for the negotiation of a radical new economic integration agreement with Washington.

CUFTA had brought significant, but not regime-altering changes to Canada.[4] The extension of the National Treatment norm from goods to investment, for instance, had required Ottawa and the Canadian provinces to bring to an end some three decades' worth of industrial-development policies that had been aimed to shore up the capacities of domestic Canadian corporations to compete with larger foreign – mainly American – companies. NAFTA signified the constitutionalization of far more intrusive and demanding changes for Mexico. Steep tariff reductions would expose Mexican retailers and farmers to the competitive onslaught of the United States' industries and retailing chains. A common-law legal system for handling antidumping and countervailing duty actions had to be imported holus-bolus into Mexico's civil code system.[5]

[3]For a review of the literature on Canadian-American relations see Smith, Doing the Continental: Conceptualizations of the Canadian-American Relationship in the Long Twentieth Century, Canadian-American Public Policy 44 (2000).

[4]See Weir, Lies, Damned Lies, and Trade Statistics: North American Integration and the Exaggeration of Canadian Imports, Canadian-American Public Policy 63 (2005).

[5]Leycegui/Fernandez de Castro, *Socios naturales? Cinco años del tratado de libre comercio de America del Norte*, 2000. Top of Form.

The question I will address for this yearbook's readers is what long-term significance NAFTA has had for international economic law. To provide an answer, I need to review the region's norm-generating performance over its first 15 years. This exercise will generate the analytical context which will allow me to assess the implications for North America's contribution to international economic law of the developments that have occurred in the last year.

The Failed Promise: NAFTA's First 15 Years

Although academic commentary on NAFTA was not phrased in terms of "international economic law," specialists implicitly accepted the new entity's importance as a norm-generating regime.[6] It is still not unusual to read such statements as "in January 1994, North America formally entered the club of world regions, launching the project of an integrated economic space."[7] Reflecting on NAFTA's first decade, the American political scientist Robert Pastor affirmed in a similar spirit that "[f]or the first time, 'North America' is more than just a geographical expression," with NAFTA being "merely the first draft of an economic constitution for North America." [8]

While it is tempting to join Pastor in visualizing North America as a continental community,[9] whose subsequent "drafts" will approximate the sophisticated governance of the European Union, this essay's main contention is that, although constituted as a world region, North America subsequently failed to realize its juridical promise. I will make my case in three stages. First, NAFTA's remarkably weak *institutions* are, with one important exception, incapable of generating economic norms "from above" beyond those found in the original treaty. Second, no economic sector has proven capable of generating economic norms "from below." Third, since September 11, 2001, the abrupt, even paranoid US shift to an anti-terrorist, border-security paradigm caused the regionally **integrating** economic constitution created by NAFTA to unravel.

The Norm-Making Potential of the Region's Institutions

Most international economic law is generated by properly constituted institutions such as the World Trade Organization (WTO). The North American continent seemed to acquire this capacity when NAFTA was born, but the new regime turned

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[6]Randall et al., *North America without Borders? Integrating Canada, the United States, and Mexico*, 1992.

[7]Castro-Rea, Are US business priorities driving continental integration?, Edmonton Journal (27 March 2006).

[8]Pastor, North America's Second Decade, Foreign Affairs 83:1 (Jan/Feb 2004), pp. 124 et seq.

[9]Pastor, *Toward a North American Community: Lessons from the Old World for the New*, 2001.

out to be largely hollow. It had no legal personality, so – unlike the European Commission – could not negotiate international agreements. With no executive, legislative, or administrative bodies of note, only its judicial provisions could claim any substance. Even as instruments of conflict resolution, NAFTA's dispute-settlement mechanisms proved largely ineffectual. On issues where powerful US lobbies wielded political clout, the site of governance that decided the outcome of disputes was Washington which has systematically refused to comply with judgments favouring Canada and Mexico by NAFTA's arbitral panels.[10]

NAFTA's institutional vacuum does not mean that its norms, rules, and rights are inconsequential. On the contrary, these three components of what became part of what can be understood as each signatory's external constitution[11] severely disciplined the practices of the two peripheral states, if not those of the centre. For instance:

– Applying the national treatment *norm* to investment nailed shut the coffin of Mexico's import substitution industrialization model, which had delivered an annual growth rate of 6% from World War II to the early 1980s.
– Dozens of new *rules* prohibited Canada, for example, from charging for the petroleum it was exporting to the United States a higher price than that prevailing in the domestic market or from reducing these exports to preserve diminishing energy reserves. For its part, Mexico agreed to open up its banking sector to foreign ownership.
– Important new *rights* were granted North American investors who could now directly sue host governments from the municipal to the federal levels for regulations they deemed tantamount to expropriating their corporations.

Although these norms, rules, and rights were consequential, NAFTA's actual institutions had little substance. To be sure, NAFTA has an executive body, the North American Free Trade Commission, but this body has no staff, no address, and no budget. Despite the substantial responsibilities for managing NAFTA's implementation conferred on it by the Agreement, this Trade Commission consists solely of sporadic meetings by the three countries' trade minister, secretary, or representative who have turned out to be loath to make major decisions.

As for a legislative capacity to add to or amend NAFTA's new norms, rules, or rights – a necessary feature of any multilateral body that hopes to retain its relevance as conditions evolve – this "world region" has none. Changing NAFTA's norms requires trilateral intergovernmental negotiations by the three states' federal executives – a phenomenon that successfully occurred only once – on July 31, 2001

[10]Hufbauer/Schott, *NAFTA Revisited: Achievements and Challenges*, 2005.

[11]For an elaboration of the argument that continental free trade agreements combined with the World Trade Organization comprise an external constitution for its member-states, see Clarkson, Canada's External Constitution under Global Trade Governance, in: Gendreau (ed.), *Dessiner la société par le droit/Mapping Society Through Law*, 2004, pp. 1–31.

when the three parties managed to make a slight clarification of the meaning of "customary international law." [12]

Nor does NAFTA have much in the way of an administrative arm. Buried in each of the three governments' trade departments, there is a small office responsible for documenting NAFTA-related business, primarily the state of its dispute settlement processes. NAFTA's remaining bureaucratic sinew consists of some 30 committees and working groups mandated by the Agreement's various chapters. These trinational groupings, which are, in theory, staffed by middle-level civil servants from each federal government, barely exist in practice.[13]

Two other institutions which were appended to NAFTA following Gov. Bill Clinton's election in 1992 turned out to solve the contradictory political problems for which they were designed. On the one hand, the North American Commission for Labour Cooperation (NACLC) and the North American Commission for Environmental Cooperation (NACEC) mollified the concerns of the US labour and environmental movements which feared that Mexico would attract jobs and exacerbate pollution thanks to US firms outsourcing their assembly-line operations to its low-standards maquiladora factories. On the other hand, the legal provisions governing these commissions' powers were so convoluted that the government of Mexico was assured that they would have no teeth to force it to raise labour and environmental standards and so lose what little competitive advantage NAFTA had accorded it. [14]

NAFTA's only institutional features with any strength are judicial. But of its half dozen different dispute settlement mechanisms, two have remained dormant (those relating to energy and financial institutions) and two were successfully designed to be ineffectual (those of NACLC and NACEC).

The Agreement's chief conflict resolution processes are specified in Chapters 20, 19, and 11. Disputes between the parties over the interpretation and implementation of NAFTA's provisions were to be resolved by binational panels established under Chapter 20's clauses, but the panel rulings merely take the form of recommendations submitted to the NAFTA trade commission – that is, the three trade ministers – who, in turn, can only offer suggestions to their governments about how to proceed. When, for instance, after long delays caused by Washington's deliberate obstructionism, a NAFTA panel ruled that the US government had failed to honour its obligation to allow Mexican truckers access to its market, Washington was not obligated to change its ways and, indeed, still persists in its non-compliance.

Putatively binding rulings are made by panels established under Chapter 19, which substitute for domestic legal appeals of the antidumping or countervailing

[12]Weiler, NAFTA Investment Arbitration and the Growth of International Economic Law, Canadian Business Law Journal 26 (2002), pp. 405–435.

[13]Clarkson/Davidson Ladly/Merwart/Thorne, The Primitive Realities of Continental Governance in North America, in: Grande/Pauly (eds.), *Complex Sovereignty: Reconstituting Political Authority in the Twenty-first Century*, 2005, pp. 168–194.

[14]Cameron/Wise, The Political Impact of NAFTA on Mexico: Reflections on the Political Economy of Democratization, Canadian Journal of Political Science 37 (June 2004) 2, pp. 301–323.

duty determinations made by individual states' trade-administrative tribunals. While useful in the majority of cases, the US government's refusal to comply with these rulings in its long-drawn-out dispute with Canada over countervailing duties on softwood lumber imports underlines the point that NAFTA's institutions enjoy strikingly little clout when it comes to containing the unilateral propensities of the region's hegemon.[15]

The single arbitral function with definite muscle is the investor-state dispute process established in Chapter 11, which allows NAFTA corporations to initiate an arbitration process governed by World Bank rules in order to challenge the validity of a domestic measure they claim has been tantamount to expropriating their assets. Because these rulings have domestic effect in the defendant jurisdiction, they have been the cause of much dismay among jurists who protest the derogation of national judicial sovereignty and among environmentalists who believe the threat of such actions prevents the necessary regulation of corporate polluters. NAFTA's investor-state dispute settlement represents the treaty's single, important, and disconcerting contribution to international economic law. By giving foreign corporations greater rights in nation states than those enjoyed by domestic corporations and by giving these TNCs the right to take disputes with governments directly to international commercial tribunals without having to exhaust the remedies available to them in domestic courts, NAFTA has supported the trend to de-territorializing, privatizing, and de-democratizing the resolution of disputes between international capital and public policy.[16]

In short, the capacity to generate regional economic law established by NAFTA's institutions is considerably less than observers had cause to expect when originally listening either to its proponents or its opponents.

Norm-Making Capabilities of the Region's Various Economic Sectors

Even if North America is less institutionally imposing than the original fanfare over NAFTA had led many to hope or fear, the continent may have a greater political-economic reality in other, more commercial respects.[17] Transborder governance can develop when clashes of economic interests need to be resolved or when transnational corporate demands need to be addressed. In such sectors as agriculture

[15]In contrast with the coercive control exercised by an imperial power, "hegemon" is used in this chapter to denote the leader of a regime whose weaker members participate in formulating the norms and rules by which the system is governed.

[16]Vega/Winham, The Role of NAFTA Dispute Settlement in the Management of Canadian, Mexican, and U.S. Trade and Investment Relations, Ohio Northern University Law Review 28 (2002) 3, pp. 651–706.

[17]Weintraub et al., *Free trade in the Americas: Economic and Political Issues for Governments and Firms*, 2004.

and steel where geographical proximity matters, powerful US transnational corporations have generated elements of a continental political economy. In the wheat and corn markets for example, food processing transnationals have largely overcome domestic farmers' resistance to imports – whether of Canadian wheat to the United States or of US corn to Mexico.

This section will consider three instructive cases: steel, automobiles, and textiles. The steel industry experienced unintended consequences from the agreement, and if NAFTA produced any winners, these were surely the US auto and textile sectors, which had managed to obtain rules-of-origin protection – at least for a time – from their Asian and European competitors.

Sectoral Continentalization: Steel

In spite of the fact that, as traditional heavy industry, steel provides the backbone of the old manufacturing economy, it did not do well under NAFTA which, its bold name notwithstanding, did not create a genuine free trade area. Since the agreement failed to eliminate or even circumscribe the protectionist anti-dumping and countervailing-duty actions with which the US steel industry had long been harassing imports from Canada, Canadian steel companies invested heavily in the US market. Their American subsidiaries became active as members of such US industry associations as the American Iron and Steel Institute (AISI) and proceeded to lobby – along with the US steelworkers' union, which had fortuitously been run for a decade by Canadian presidents – to exempt Canada (and also Mexico) from the Bush administration's safeguard duties on foreign steel imports. This collaborative action suggested that, in the steel sector, a single, if informal, governance space was developing in which Canadian, and later Mexican, firms partially Americanized themselves within the US economy, rather than create a continent-wide industry made up of nationally competitive elements. Symptomatic of this trilateralism was the creation of an instrument of trinational governance, the North American Steel Trade Committee – significantly an offshoot of the AISI. The NASTC involved the three governments with their respective industry associations in order to develop common North American policy positions to present at the OECD, the World Trade Organization, and the now-defunct negotiations for a Free Trade Area of the Americas.

The Canadian steel industry was much better positioned to participate in the US economy than was its Mexican counterpart, which – having flourished, if inefficiently within the national space created by import substitution industrialization following World War II – was seriously weakened by the lifting of government protection in the 1980s. But the acquisition in 2006 of all six of Canada's largest domestically owned steel corporations by Brazilian, Indian, and American conglomerates suggests that NASTC's apparently continental regulatory consolidation is being trumped by the steel industry's corporate globalization. While the sector may remain a predominantly regional production system under global ownership, it

has not evolved any norm-generating capacity beyond NASTC's limited capacity for consultation with the three national industries.

Automobiles

As the culmination of many years of US automotive transnational corporations (TNCs)' lobbying, NAFTA was thought to have set up a fully integrated system of production for those manufacturers – principally the Detroit Three – that could meet its protectionist rules-of-origin requirements. However, the trilateral working groups created to negotiate continental safety and emissions standards proved incapable of producing the regulatory harmonization necessary for a fully integrated continental production system.

Meanwhile, global competition undermined the American auto assemblers' oligopolistic dominance in the continent. Transcontinental corporate consolidation through mergers and equity linkages, which had created six automotive groups accounting for 80% of world production, was developing a regime of accumulation which was truly global, generating pressures to create a globally harmonized system of regulation for the automotive industry. At the same time, continuing foreign auto and auto-parts investment in both Ontario (which boasts an excellent transportation infrastructure and the substantial benefits for employers of a publicly funded medical system) and Mexico (which offers well-trained labour power at one fourteenth of US wages) reduced the disparity between the two peripheries' car economies. This continental industrial space had become more integrated internally at the same time as it had become more integrated globally when the 2008 global economic crisis occurred. The dominant role played by Washington and the major funding contributed by Ottawa to the bailout of Chrysler and General Motors showed how vulnerable was continental market liberalization to national regulatory recapture.

Textiles

NAFTA's rules of origin also appeared to succeed in connecting the three countries' disparate textile and apparel industries in a common North American production system, in which US interests combined more intimately with burgeoning Mexican firms than they did with shrinking Canadian companies. The asymmetries in this trilateral matrimony grew as NAFTA-generated continental market governance collapsed in the face of two exogenous adversities – the expiry of the Multi-Fibre Agreement (which had allowed industrialized countries to impose draconian quantitative limitations on apparel imports from the Third World) and China's emergence as the dominant supplier flooding the North American market.

Continental production in a severely shaken textile and apparel industry still revolves around an American hub, with US industry responding unilaterally to its challenges, a battered Mexican industry retreating to the informal economy while

supporting Washington's endeavours, and a no longer protected Canadian sector pushed to the sidelines. Continental governance in this sector amounts to little more than NAFTA's ageing rules of origin made increasingly irrelevant by Washington's bilateral agreements with other trading partners. Far from being a privileged member of a regional regime, Mexico found itself discriminated against in the United States' Central America Free Trade Agreement, CAFTA.

The Significance of Trinational Policy Harmonization Within Global Corporate Governance

Although some North American industries have been regionalized in the sense that they have been brought within the United States' political economy, signs of trinational policy harmonization may have nothing to do with regional governance in other economic sectors where geography is of minor importance.

Intellectual Property Rights for Pharmaceuticals

Changes to the intellectual property rights (IPRs) regime for pharmaceuticals in North America are particularly revelatory. The United States had pressed hard in the 1980s for strong intellectual property monopoly rights to be endorsed by other countries. Fearing a public outcry over the throttling of Canada's generic drug industry, Ottawa had resisted having CUFTA include IPRs that would strengthen Big Pharma. It had nevertheless bowed to Washington's pressure and passed national legislation which had the same effect. Objections from such rising third-world economies as Brazil and India to the United States/European Union IPR proposals had been one factor blocking the GATT's Uruguay Round negotiations. Canada's resistance already overcome, Washington had little trouble imposing on Mexico as one of its deal breakers a strong IPR regime which became Chapter 17 of the agreement.

NAFTA's IPR value for Washington was more tactical than strategic. It justified investing political capital and administrative resources to create a legal regime for North America as a way to persuade its GATT partners that, unless they bent themselves to its will, they might find themselves facing a Fortress North America with regional economic norms that discriminated against Washington's overseas competitors. The WTO's resulting TRIPs agreement represented the triumph of US Big Pharma and its European and Japanese pharmaceutical counterparts in achieving a new global legal regime for this sector.

NAFTA's Chapter 17, which was copied from the Uruguay Round's Dunkel draft, is almost identical with the WTO's TRIPs agreement. But Chapter 17 has turned out to be a dead letter because Big Pharma has no use for it – for two reasons. The WTO's settlement mechanism is more muscular than NAFTA's. And should

big Pharma win its case against Ottawa at the WTO, the ruling ipso facto makes law around the world, thus expanding the new norm's reach far beyond North America.

The fact that Washington used the WTO's dispute settlement body – rather than NAFTA's – as its legal venue for pressing Canada to make further concessions to US branded drug companies suggests that weak continental judicial governance has been trumped by the stronger alternative established at the global level. If European big Pharma has used the WTO's dispute settlement process to force Canada and Mexico to provide longer protection periods for proprietary drugs than they had been willing to concede, this suggests North America has lost out to the WTO as a regulatory region on the global stage.

Financial Services

Banking offers a confused picture, because North America turns out – surprisingly – not to be a natural zone for continental banking. Some Canadian banks have operated for decades throughout the hemisphere and, to a lesser extent, globally, while all of them had branches in the US market well before trade liberalization. For their part, US banks had also set up shop in Canada long before free trade. Notwithstanding their geographical proximity, it was not American but British banks that predominated among foreign-owned financial services in Canada whose retail banking system remains primarily in domestic hands.

With a much less robust set of banks, which were nationalized in 1982 following one of the country's periodic currency crises, Mexico found itself at the receiving end of transnationalized banking. NAFTA had required it to open specified portions of its re-privatized banks to foreign ownership according to a defined schedule, but, in the shock of the 1995 peso crisis, the IMF, World Bank, and the US Treasury used their financial bailout to force Mexico to drop its restrictions immediately. After a feeding frenzy of foreign banks acquiring domestic partners, Mexicans found that all but one of their banks had fallen under foreign ownership, but with Spanish capital taking a larger share than American. The financial services sector in North America's three economies has thus become more globally than continentally restructured, NAFTA notwithstanding.

Although harmonization of the three banking sectors' regulatory systems has occurred within North America, this is not a result of any transborder governance created by NAFTA. Rather, this apparent continentalization actually reflects the three countries' discrete participation in global governance. If banking regulations in the United States, Mexico, and Canada were becoming more similar before the global meltdown of 2008, this was because the three central banks' participated in the monthly meetings of the Bank of International Settlements in Basel whose multilaterally negotiated norms were applied at home. Instead of banking regulations showing that North America had become a "world region," they indicated that the three countries of North America were integrating as separate players in a global mode of regulation. When in 2008-09 this global system of accumulation experienced a severe crisis, "North America" played no part in its rescue. No trilateral

summit convened to work out a North American position prior to the meetings of the G20 or G8. Like all other capitals, Ottawa and Mexico City simply waited to see what Washington would do.

The Impact on Economic Governance of the Post-"9/11" Security Paradigm

In matters of national defence since September 11, 2001, North American governance has reverted to earlier modes of government-to-government relations in which the continental hegemon presses its neighbouring governments to bend to its will, in this case to guarantee the security of the American homeland against terrorism. Provoked by the Al-Qaeda attack on New York and Washington, the US government's paradigm shift instantly affected the dynamic driving North American governance. The economic integration fostered by NAFTA had been reducing the government-made economic barriers along the United States' two territorial borders, allowing the marketplace freer rein to increase human and economic flows across the continent. Throughout the 1990s, growth in cross-border traffic in goods and people generated increased attention to border governance issues. Concerned about the efficiency of their continent-wide production systems, business coalitions lobbied their governments to make the increased investments in transportation and security technology needed to create a near-borderless continent. President Clinton had signed agreements with Ottawa in the mid-1990s to improve border security management, but his administration did not take significant steps in this direction. "9/11" generated an urgent political will in Washington to strengthen North America's border-security systems and its military defence.

Security

Washington's sudden move to a security paradigm was dramatized for North Americans on September 11 by the immediate blockade of its borders. This unilateral action demonstrated that, once Washington declared its national security to be at stake, it would simply reassert its control over the policy space it had previously vacated in the name of trade liberalization. Its subsequent demands that Canada and Mexico do what it felt was necessary to securitize their exports showed how much North American *governance* was driven by Washington's *government*.

In the post-September-11th handling of US border security, traditional binational relations reasserted themselves in response to US unilateralism, Uncle Sam dealing separately with each periphery. These intergovernmental negotiations were supplemented on the Canadian side by an unusually active business-coalition's involvement in the design of new security systems. This new intensity of heterarchical governance impinged on the traditional, government-to-government

hierarchy. During the American war on terror's first phase, a detailed 30-point US-Canada Smart Border agreement was signed in Ottawa in December 2001. By March 2002, Washington had negotiated a parallel 22-point Smart Border agreement with Mexico City. Subsequently, Canada and Mexico's bilateral collaboration added a third relationship to intergovernmental security relations within North America. This reactivated regionalism was unusual. On the one hand, it reinforced Washington's dominance by incorporating Canada and Mexico in an extended zone of US-led continental policy making. At the same time, the new trilateralism reduced the power asymmetry between the hegemon and the periphery because US security became dependent on the Mexican and Canadian governments' fulfilling their anti-terrorism policy commitments.

In a political context in which Washington's security concerns trumped its regional trade and investment interests and even its obligations, North America became a region more divided by national security controls than integrated through international economic law.[18]

Re-Institutionalizing the Region: The Security and Prosperity Partnership of North America

Following the argument so far, the reader will have seen that, as a "world region," the North America created by NAFTA does not add up to much in institutional terms.[19] While the continental steel industry provided one short-lived example of continental transborder governance, other domains such as intellectual property rights and financial services showed that what appeared to be continental regulatory harmonization was actually the result of the three countries' participating in global governance. A fourth North American reality, which has become particularly evident since Washington declared its global war on terrorism can be seen in the US-driven intergovernmental effort to build a new continental security perimeter while creating trade-inhibiting barriers along the United States' northern and southern land borders.

Although the first years following September 2001 showed North America to be a more unilateral, US-defined political space, the proclamation of a Security and Prosperity Partnership for North America (SPP) by the three governments' leaders following their March 2005 meeting in Waco, Texas appeared to herald a shift towards a more trilateral continent. Nationalist critics in the three countries feared SPP was a manoeuvre through which the executives in Canada and Mexico were advancing their agenda stealthily to integrate their political systems with each other. Corporate leaders in the three countries, who aspire to operate in a borderless North America because their production chains included operations in each of the

[18]Golob, North America Beyond NAFTA? Sovereignty, Identity, and Security in Canada-U.S. Relations, Canadian-American Public Policy 52 (2002).

[19]Studer/Wise, *Requiem or Revival? The Promise of North American Integration*, 2007.

continent's three economies, criticized SPP as a mere wish list of low-profile bureaucratic initiatives whose implementation would do nothing to engage with the major challenges facing the continent including a common currency, a customs union, or a fully integrated energy market.

As seen by the Mexican presidency, SPP presented an opportunity to resolve many irritating problems in the bilateral economic relationship and so move NAFTA incrementally towards Mexico's grander vision of an EU-type regional governance. The new strategy involved a trade-off. First, Mexico would comply fully with US demands on security matters. Once it gained access to the US policy loop, it would negotiate the regulatory corollaries that applied to trade. If SPP negotiations could produce certification standards governing Mexican foodstuffs, such Mexican products as avocados would no longer be vulnerable to border stoppages arbitrarily declared by the US Food and Drug Administration. This negotiated regime would then give Mexico's agricultural exporters some competitive advantage in responding to US farm lobby demands over their rivals in Latin America, Asia, and even Europe.

While the bulk of SPP's proposed measures dealt with either the US-Canada or the US-Mexico relationship, the informal telephone and e-mail communications among the bureaucrats who had put them together suggested that some significant informal trilateral regulatory space was being created in the process. Although the security side of SPP extended Washington's dominance in the continent beyond any point it had previously achieved, the prosperity issues seemed to offer some counter-asymmetrical power for the periphery. "Regulatory harmonization" might conjure up images of Mexico and Canada simply having to adopt US standards, but the complexities and differences between each country's multi-level governmental system dictated that this nightmare would not be achieved by American bullying. Instead, issues would have to be worked out pragmatically with Washington accepting its incapacity simply to impose its norms on the periphery. In some cases, the American officials would still be giving their Mexican counterparts the familiar "do it our way or your product will not cross our border" message. In others, a practical problem would have to be worked out by all parties resolving their problems cooperatively.

As for whether the SPP could lead ineluctably to the implementation of a common market, vehement opposition from civil society combined with passionate resistance within the US government to creating continental institutions makes this scenario unlikely.[20] Even though the three countries' executives were engaging the upper-middle ranks of their bureaucracies, they paid virtually no attention to each other's interests when negotiating new trade agreements with other countries. They have shown little sign – apart from some trilateralism in the steel sector– of moving towards a common position on international economic policy, let alone a common foreign policy.[21]

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[20]Huelsemeyer, Toward Deeper North American Integration: A Customs Union? Canadian-American Public Policy 59 (2004).

[21]Bow, "When in Rome", Comparing Canadian and Mexican Strategies for Influencing Policy Outcomes in the United States, Canadian-American Public Policy 65 (2006).

The Implications of NAFTA's Failed Promise

As one among a number of world regions, North America is an enigma displaying many diverse realities. This conclusion will extrapolate from the four realities involving North America's inter-state relations and its marketplace in 2010.

1. NAFTA created a formal governance mode, but its institutions were too weak to construct mechanisms that would generate a self-sustaining capacity to generate transnational economic legal norms. Nor could these institutions offset the power of the dominant member while boosting that of the smaller ones, as they do in Europe, where it is all but impossible to account for developments within the member states without reference to European-Union-level processes and policies. In contrast, NAFTA's rule changes obliged Canada and Mexico to conform to American objectives, while the United States refused to accept disciplines limiting its trade protection legislation or restricting its autonomy to subsidize producers.[22]
2. NAFTA's norms favoured the transnational operations of large corporations, most of which are American, and its investor-state dispute settlement panels favoured the strong transnational investors over the periphery's weaker governments. The application to North America of the neoconservative paradigm successfully constrained the two peripheral governments on one hand and liberated corporations on the other. As a result, private actors' involvement in policy areas increased, but mainly through issue networks in which TNCs played large but spontaneous, non-institutionalized, and so unpredictable roles in generating new economic norms.[23]

   Having failed to gain exemptions from US trade protectionist processes, the two peripheries' industries converged on the centre. Complex rules of origin caused large structural adjustments in the textile and apparel industries while not protecting either them or the auto sector from the impact of changes in global governance (end of Multi-Fibre Agreement), the global balance of power (China), or trans-oceanic corporate restructuring.

   In all the sectors where geographical proximity mattered, North America became a space in which the reach of US domestic politics extended to decide outcomes crucial to such Mexican and Canadian exports as beef and wheat. Although the movement of global investment brought large American, Mexican, and Canadian smelters under foreign control, steel provides a rare example of an economic sector experimenting with trilateral participation in transnational lawmaking with the three domestic industries, their national lobby organizations, and the three federal governments all learning to cooperate in hemispheric and global negotiations.

[22]Globerman/Walker, *Assessing NAFTA: A Trinational Analysis*, 1993.

[23]Shamsie/Grinspun, *Whose Canada? Continental Integration, Fortress North America, and the Corporate Agenda*, 2007.

3. Multilevel transborder economic law for the pharmaceutical industry is different from what we would expect if North America were a genuinely continental space. Global governance (TRIPs) prevailed over NAFTA's putative continental governance. New intellectual property rights expanded US pharmaceutical TNCs' dominance in the two peripheral economies. At the same time, the prime factor accounting for exogenous changes in Canada's and Mexico's IPR regime remains direct pressure and threats from Washington.
   Because banking norms are negotiated in an international forum where US power is offset by that of Europe and Asia, US control over the North American periphery in financial services actually diminished. This regulatory shift reveals that transnational norm setting in North America's banking space is less continental than it is global, even though its regulatory imbalance and power asymmetries have diminished.
4. Transnational economic lawmaking in North America has been marginalized by the social crisis presented by escalating narcotics cartel violence. Responding to US security concerns involves continuous intergovernmental negotiation on specific policy issues, the bilateral US–Mexico Merida Initiative of 2007 providing a perhaps historic precedent in which Washington recognized how much of its own societal security depends on Mexico's bringing its outlaw drug cartels under control, while Mexico City conceded it could not achieve domestic security without massive US financial and technological assistance.

The rule of continental economic law is now contextualized by the more powerful imperative of anti-terrorist and anti-narcotics security. Although narco-traffic and immigration pressures were far more intense along its southern than its northern border, Congress pushed the Administration to adopt common policies on biometric identity cards for all persons crossing US borders. The Barack Obama administration's insistence that the two borders be treated equally has further sidelined trilateral economic governance.

The 2005 Security and Prosperity Partnership of North America reaffirmed the three federal governments' desire to reconcile the US demand for maximum border security with the periphery's need for minimum border-trade restrictions. Supplementing the SPP with an annual leaders' summit moved forward the process of institution building but did not herald North America embarking on any grander institutional project. Nationalist opposition to the SPP – from the right in the United States and from the left in Mexico and Canada – caused this effort to strengthen continental regulatory harmonization to be terminated by President Obama.

In terms of international economic law at the regional level, we can see that North America is not destined to develop along the lines of the European model of strong transnational norm making and authoritative arbitration. To be sure, there may be many transborder networks such as Mexico's vast system of US consulates in the United States – the largest of any country in the world – which try to mobilize documented or undocumented Mexican–Americans behind the tricolour flag. Sub-central entities such as Canadian provinces enter climate-change policy regimes with their counterpart American states. Diverse political arenas

interconnect spasmodically in systems involving continuous interactions. But these forms of transnational governance do not often generate norms with significant economic implications. In sum, we can see that North America remains largely what it was before NAFTA formally trilateralized Washington's two immediate bilateral relationships, one remaining consensual and the other conflictual.[24]

The Implications of Recent Political Shifts in the Three Member States

Since this political-economy analysis suggests strongly that North America's jurisprudential significance is quite limited in terms of regional economic integration, there remains relatively little to say about the specific implications of the last year's developments.

Under the Obama administration, governance changes are likely for North America in at least three areas. The huge informal cross-border labour market, in which Canada and Mexico respectively constitute the largest suppliers of trained and unskilled labourer to the United States, is crying out for overt regulation. The gigantic illegal cross-border narcotics traffic – and the supply of high-powered weapons by US manufacturers to the Mexican and Canadian drug cartels – will have to be addressed lest Mexico collapse as a failed state. A cap and trade system to contain the environmental catastrophe of climate warming would best function if the three countries adopt a common system. Canada and Mexico are very much part of the problem in these three fields, but it appears that domestic US politics will once again determine the parameters for their solution.[25] Although the US Administration is toying with the progressive idea of an amnesty to legalize undocumented Mexican immigrants, powerful xenophobic sentiments still support the extension of a security wall between the United States and Mexico.[26]

For its part, Canada is erecting walls of its own, although in this case these are politically constructed. The Stephen Harper government has pointedly undermined North America's embryonic trilateralism by requiring all Mexicans – including tourists – wanting to come to Canada to apply for visas in a process which is humiliating for applicants.

Humiliated by Canada and walled off by the United States, the Mexican government finds itself isolated from rather than integrated in the two developed economies to the north with which it implemented NAFTA 16 years ago.

[24]Fry/Bybee, NAFTA 2002: A Cost/Benefit Analysis for the United States, Canada, and Mexico, Canadian-American Public Policy 49 (2002).

[25]Harrison, The Road not Taken: Climate Change Policy in Canada and the United States, Global Environmental Politics 7 (November 2007) 4.

[26]Abu-Laban/Jhappan/Rocher (eds.), *Politics in North America: Redefining Continental Relations*, 2008.

In other words, the present political conjuncture in North America's three polities augurs poorly for positive jurisprudential developments. When security concerns trump trade liberalization, international economic law takes the back seat in terms of regional integration.

African Regional Economic Integration: Is the Paradigm Relevant and Appropriate?

Colin McCarthy

Introduction

Regional economic integration has been an important item on the African economic development agenda for many years. The first formal regional integration arrangements (RIAs) were established in colonial times, for example, the world's oldest operating customs union, the Southern African Customs Union (SACU) in 1910.[1] During the post-colonial period, especially since the 1970s, the number of RIAs has grown sharply to 15 groupings.[2]

The political economy of African integration has four characteristics that are relevant to the theme that will be developed in this paper. First, the 53 African countries belong to more than one RIA. In southern Africa, for example, excluding the CMA, South Africa is a member of SACU and the Southern African Development Community (SADC),[3] while Swaziland belongs to both, as well as to the Common Market of Eastern and Southern Africa (COMESA).[4] Across the

[1]The members of SACU are Botswana, Lesotho, Namibia, South Africa and Swaziland. The SACU Agreement concluded in 1910 incorporated the Union of South Africa, and the British High Commission Territories of Bechuanaland (Botswana), Basutoland (Lesotho) and Swaziland. When Namibia gained independence in 1990 it joined SACU, having previously been included as part of South Africa, which governed South West Africa (Namibia) as a League of Nations protectorate.

[2]Economic Commission for Africa, *Assessing Regional Integration in Africa*, ECA Policy Research Report, 2004, p. 39.

[3]The member states of SADC are Angola, Botswana, Democratic Republic of the Congo (DRC), Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. Madagascar was suspended in March 2009 after the ousting of the democratically-elected president, Marc Ravalomanana.

[4]COMESA has the following as member states: Angola, Burundi, Comoros, DRC, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. Comparing SADC and COMESA membership it is clear that eight countries belong to both RIAs.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_15, © Springer-Verlag Berlin Heidelberg 2011

continent multiple membership applies to 27 countries that belong to two regional integration arrangements, 18 to three, and one country to four regional groupings.[5] Second, most African RIAs adopt the linear model of regional integration, starting with a free trade area and aiming step-wise for at least a common market or in most cases economic union. Third, in broad terms a building bloc hypothesis applies in the sense that the RIAs are seen as stepping stones towards the continental economic unity envisaged by the African Union.

In the fourth place, the enthusiasm for regional integration reflected in the number of arrangements and the political rhetoric on the value attached to integration is not matched by the progress made. If progress in integration is measured by the achievement of the objectives formally adopted and by the growth in intra-regional trade, the consensus is that African regional integration has been a failure. As far as institutional development is concerned none of the regional integration arrangements, regardless of ambitious intentions, have developed functional customs unions, while the growth in intra-regional trade expected of regional integration has not materialised; in brief, there is "consensus that regional integration efforts in Africa registered disappointing results".[6] Compared to other developing areas the level of African intra-regional trade is low, namely an average of 8.7% for exports during 2004–2006, which is significantly lower than the 18.5% for Developing America and 45.5% for Developing Asia.[7]

These characteristics feature prominently in this paper, which argues that although regional integration and cooperation is an imperative if African economies are to address their poor economic conditions and marginalisation in the world economy, an undue emphasis on the formal model of linear integration without the requisite attention given at the national level to the creation of capacities to produce tradable goods competitively, is bound to lead to poor results. In addition to the production capacity problem, meticulous adherence to the linear integration model fails to address the many non-tariff barriers to trade, thus resulting in the poor growth in intraregional trade.

The paper commences with a brief consideration in Section 2 of the essential impact of regional economic integration and of the linear model of integration in order to enhance understanding of the African integration rationale, which is discussed in Section 3. The latter section is concluded with an overview of the integration arrangements in southern Africa; these arrangements aptly illustrate the institutional architecture on which the linear model and the building bloc hypothesis are based. The linear model is assessed in Section 4. The question addressed is whether the step-wise and sequential movement to deeper levels of integration will

[5]United Nations Conference on Trade and Development, *Economic Development in Africa Report 2009, Strengthening Regional Economic Integration for Africa's Development*, 2009, p. 11.

[6]Geda/Kebret, Regional Economic Integration in Africa: A Review of Problems and Prospects with a Case Study of COMESA, Journal of African Economies 17 (2008), p. 357 (381).

[7]United Nations Conference on Trade and Development, *Economic Development in Africa Report 2009, Strengthening Regional Economic Integration for Africa's Development*, 2009, p. 21.

address the barriers to intra-regional trade and development that typically exist in Africa. Summary conclusions are given in Section 5.

Impact of Regional Economic Integration and the Linear Model

Goods and non-factor services are traded internationally. Economies are also open to international factor flows, both capital and labour. Regional economic integration essentially represents efforts to remove border barriers to the cross-border flow of goods and factor and non-factor services among the member states of the integration arrangement, thus contributing to the welfare creation associated with increasing trade and investment.

Integration can take on different forms. Conventionally it starts with removal of border barriers to trade in goods within a defined region. In the system of multilateral trade management by the World Trade Organisation (WTO) the principle of non-discrimination, embodied in the most-favoured-nation (MFN) clause,[8] is a key canon. However, the General Agreement on Tariffs and Trade (GATT) allows exceptions to the MFN clause, one of which is contained in Article XXIV of the GATT. This allows the establishment of free trade areas and customs unions within which trade is free while tariff barriers are maintained against non-member states. In the case of a customs union the member states share a common external tariff vis-à-vis non-members.

Regional economic integration can be extended by including trade in services, both non-factor services such financial, commercial, transport and professional services and unrestrained capital and labour flows. Services are typically constrained by national regulations which need to be amended and harmonised to facilitate cross-border activity should this be the intention of the integration arrangement.

Integration reaches its pinnacle when monetary and fiscal integration is added to free trade in goods and services. The ultimate form of monetary integration is monetary union, that is, adopting a single currency, issued and managed by a regional central bank. Having a single currency within an integrated region further reduces the transaction costs of trade and also removes the ubiquitous problem of exchange rate uncertainty with its negative impact on intra-regional trade and cross-border investment. Macro-economic policy can be further integrated by the introduction of fiscal policy harmonisation.

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[8]The MFN clause determines that with respect to duties on trade "any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties". The General Agreement on Tariffs and Trade 1947, Article 1, in: World Trade Organization, *The Legal Texts of the Uruguay Round of Multilateral Trade Negotiations*, 1999, p. 423 (424).

A central argument of this paper is that the use of the different forms of regional integration – free trade area, customs union, common market and economic union – as descriptive terms that define and delineate the various arrangements of deeper integration must be distinguished from a mode of implementation that accepts a process of step-wise, sequential implementation of deeper integration arrangements. The latter process commits member states by formal or less-formal agreement to establish the deeper forms of integration according to a predetermined timetable. SADC serves as a good example of an arrangement that has committed itself to the linear model. However, it is contended that the commitment to an integration roadmap, with ambitious target dates that often are not met, can serve as a constraint to regional cooperation and integration and consequently, that growth in intra-regional trade and cross-border investment and regional development suffer.

Rationale of Regional Integration in Africa

Regional integration has taken on particular importance in the African development effort. A first question to address is how integration can be justified along conventional lines, before considering the specific experience with integration in Africa.

Economic Justification

Conventionally, the benefits from economic integration are divided into two categories. The first is the static welfare impact of market integration that manifests as the once-off, short term change in the welfare of society following market integration, and the second is the dynamic consequences that encompass the longer term growth outcome of integration.

Static Welfare Impact

The welfare effect exists because market integration allows consumers to choose from a wider variety of goods trading at different prices. The welfare impact can in aggregate be either negative or positive. Should trade creation (higher-cost production in the region is replaced by lower-cost products from elsewhere in and outside the region) exceed trade diversion (higher-cost product from within the region replaces lower-cost products from the rest of the world) the outcome is positive, and negative should the opposite apply.

Trade creation or diversion can be the outcome of either the establishment of a free trade area or a customs union, but the literature on market integration devotes most attention to the outcome of customs union formation. Many generalisations

exist on whether the adoption of a common external tariff, in the case of customs union formation, will predominantly be trade-creating or trade-diverting, and while most generalisations depend on the circumstances of each customs union it has been pointed out that certain general conditions can be identified.[9]

- The likelihood of trade creation increases with the size of the customs union and the number of member states.
- Should the average tariff after union be lower than before union trade creation will be a more likely outcome.
- Trade creation is more likely if the production structures of the member states are more competitive (producing similar goods) with a significant range in producer efficiency reflected in differences in unit costs. This creates more scope for the re-allocation of resources from higher- to lower-cost producers in the customs union.

The typical African integration community does not meet these requirements. Intra-regional trade is low. Most African countries are still locked into the trade patterns of colonial times, exporting a limited range of primary products to industrialised economies while importing most manufactured goods in return. A group of neighbouring commodity-producing economies with limited industrial capacity to produce tradable manufactures do not meet the conditions required for trade creation.

In 2008, 17.8% of SSA exports were destined for intra-regional trade.[10] If the exports of South Africa to the rest of SSA (4.3% of SSA exports) are accounted for the share of intra-regional trade is lower than 15%. Most world exports to SSA have their origin in Europe, although this share has declined from 41.6% in 2000 to 32% in 2008. Europe remains an important destination for SSA exports although its share has declined from 33.8 to 27.9%. Growth in SSA exports to the developed economies in North America (USA predominantly) and the Asia-Pacific region (Japan predominantly) has more than compensated for the fall in the share of SSA exports destined for Europe, increasing SSA exports to developed economies significantly from 60% in 2000 to 68.8% in 2008. China has recently grown into a very significant trade partner for SSA, increasing its share in world exports to SSA from 4.8% in 2000 to 11.2% in 2008. This growth has not been accompanied by commensurate growth in exports from SSA to China; this is reflected in the falling share of SSA exports destined for East Asia.

As far as the product composition of trade is concerned, favourable commodity markets during 2000–2008 have been the cause of a fall in the share of SSA manufactured exports in total merchandise exports from 2000 to 2008. If the custom is followed of defining goods listed in the Standard International Trade

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[9]Robson, *The Economics of International Integration*, (2nd ed.) 1998, p. 27.

[10]The trade data on which the calculations in this and the following paragraph are based were obtained from Comtrade, World exports by provenance and destination, 2009, accessed at http://comtrade.un.org/pb/.

Classification (SITC) 5–8 (Revision 3)[11] as manufactured products, the share of manufactured exports in total SSA merchandise exports declined from 16% in 2000 to 10% in 2008.

In summary, trade data confirm that SSA in general has maintained its historical trade pattern. It predominantly exports primary products to the industrialised world while importing manufactured goods from industrialised countries. In recent years the dominance of Europe in trade with Africa has fallen in favour of trade with North America and China. Concluding regional integration arrangements in SSA is for the reasons noted earlier unlikely to increase social welfare through trade creation. In fact, welfare decreasing trade diversion is a more likely outcome. It follows that for regional integration to be beneficial benefits of a dynamic nature must be realised.

Growth and Development

The growth and development benefits expected of regional integration are many. The typical argument is that an integrated regional market encourages competition among producers and also provides scale benefits in production and more opportunities for specialisation. Should a customs union be in place, the impact of the integrated market is to create more room for producers to compete in a larger protected common customs area. Even in the case of a free trade area competitive benefits exist vis-à-vis goods produced in non-member states that face tariff barriers in the member states of the FTA.

Expanding opportunities for economies of scale is likely to cause a decrease in the number of producers in the integrated region. This outcome, which implies the closure of firms as competition in the free trade environment of the region increases leaving those that survive with opportunities to benefit from economies of scale, can be linked to the force known as agglomeration economies – the benefits of size that create the dynamic of economic concentration as a snowball effect with size attracting more industry. The formation of an integrated regional market has an influence on the location decisions of firms and this, supported by forces of trade diversion, lies at the heart of economic polarisation, with more developed and larger economies in the RIA attracting growth and investment at the cost of the smaller and less developed member states. This causes specific problems that have to be managed effectively by a compensation arrangement.

It is also expected that investment will respond favourably to the larger market and more competition, lower transaction costs of trade, and a whole range of political benefits such as improved policy credibility, the maintenance and strengthening of democracy, a reduction in friction between neighbouring states, and the discipline that integration brings to governance. Although the anticipation of larger

[11]SITC 5 is chemicals, 6 is manufactured goods classified by material, 7 is machinery and transport equipment and 8 is miscellaneous manufactured articles.

investment includes domestic investment, it is generally expected that foreign direct investment will be encouraged.[12]

The positive link between regional economic integration and investment growth is not immediately clear. Much depends on the investment function of private firms, which varies between industries and sectors, and on the effect of integration on the determinants of investment. In general, the investment climate must be favourable for the expectations of potential investors, which are determined by the expected net rate of return on the planned capital outlay in an environment characterised by macro-economic, political and social stability, good governance, and in particular the existence of good institutions.

Footloose investment in manufacturing will, in addition to the determinants mentioned above, also require adequate infrastructure and skilled workers at relatively low cost, or workers with sufficient education to be trained to meet the requirements of investors. Where mineral rents are sufficiently large, experience in Africa in mining and oil extraction has shown that these determinants are not the deciding factor. It is, for example, not unusual for a mining company to invest in infrastructure, such as transport systems that are required for mineral extraction. For manufacturing, including the processing of primary commodities, this is unlikely to be the case.

The question remains whether regional economic integration has in fact contributed to a favourable investment climate. In a review of this link it was concluded that regional integration arrangements are not necessary to induce investment: "General reforms such as stabilization, market liberalization, and privatization should raise the returns to all factors and are likely to be more likely to increase private investment. . . . . .What seems to matter most is the quality of domestic policies".[13] Creating a favourable investment environment, therefore, is in the first place a national and not a regional challenge, although it cannot be denied that an integration arrangement, properly designed and managed, can improve the investment climate, especially if it addresses infrastructure development in a coordinated fashion and act as an agency of restraint in ensuring macro-economic and political stability.

African Integration Experience

The importance of regional integration is derived from the need to address the poor state in general of African economies, most of them marginalised in the global economy. The expectation that regional integration can play a positive role in improving the economic state of the continent is based on the contention that the

[12]Schiff/Winters, *Regional Integration and Development*, 2003, p. 101.

[13]Schiff/Winters, *Regional Integration and Development*, 2003, p. 115.

integration of neighbouring national markets can solve the problem of "smallness" that characterises a continent largely fragmented into small, poor economies.

A Marginalised Continent and Regional Integration

Economically, Africa has been left behind in a world characterised by a widening welfare gap between those developing countries that succeed economically and those that do not. Africa falls in the latter group as is revealed in the growing gap in per capita income between African and other developing nations.[14] The dire situation of marginalisation is particularly true for sub-Saharan African (SSA) countries that constitute no less than 34 of the 49 United Nations – denominated least developed countries (LDCs). With 12.2% of the world's population, SSA produced only 1.7% of world output and 1.9% of world exports in 2008. If South Africa, Africa's largest economy by a significant margin, is left out of the picture, the remaining 47 SSA countries, home to 11.5% of the world's population, produced only 1.2% of world output and 1.4% of world exports.[15]

African countries, as noted earlier, are predominantly producers and exporters of primary commodities and therefore benefited from the recent global economic upswing, which came to an end towards the end of 2008. The positive impact on overall economic performance was significant. In 2008, SSA's shares of 1.7% of world output and 1.9% of exports were higher than the 1.1% and 1.3% shares at the end of the 1990s.[16] However, the favourable growth circumstances of this 10-year period could not bring about a truly meaningful change in economic circumstances of the population at large. In any event the growth phase came to a sudden halt and reversed when commodity markets declined sharply in 2008/2009 in the wake of the global financial and economic crisis.

Clearly, SSA is in need of rapid poverty-alleviating economic development. In this respect regional economic integration is by no means a panacea but there can be little doubt that an appropriate development approach will have to incorporate integration, this being a necessary although not sufficient condition for rapid development in Africa. However, in developing this necessary condition the process of regional integration will have to be appropriate and adapted to the economic circumstances of the continent. The *process* of regional integration is more important than regional integration *per se*.

But why is regional integration necessary? The answer is not found in the popular political ideology of pan-Africanism but in the economic reality of having to deal with the fragmentation of the continent's economy into predominantly small

[14]Easterly, Can the West save Africa?, Journal of Economic Literature XLVII (2009), p. 378.

[15]World Bank, *World Development Indicators 2009*, 2009; the data can also be accessed at http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS.

[16]The data for 1999 was derived from World Bank, *World Development Indicators 2000*, accessed at http://siteresources.worldbank.org/INTPOVERTY/Res.

Table 1 Size of 53 African countries: distribution by population and gross domestic product, 2008

Population (mil.)	No of countries	GDP (US$ bil.)	No of countries (excl Somalia)
<2	12	<1	7
2–5	6	1–5	13
5–10	9	5–10	9
10–15	8	10–15	7
15–20	4	15–20	2
>20	14	20–40	5
		>40	9
Comparator regions and countries			
	Population (mil.)		GDP (US$ bil.)
World	6.692.0		60.115.2
Africa	982.4		1.474.0
Sub-Sahara Africa	818.7		997.2
South Africa	48.7		276.8
Nigeria	151.3		212.1
Algeria	34.4		173.9
Egypt	81.5		162.8
India	1.140.0		1.217.5
Netherlands	16.4		860.3
Ireland	4.5		281.8

Source: World Bank, *World Development Indicators 2009*, Washington, DC, 2009

and poor countries, a continent which has aptly been described as "balkanised into arbitrary nation states, frequently with scant social, geographical or economic coherence. . .".[17] Furthermore, 15 SSA countries are landlocked, nearly a third of the sub-continent's states, which is the largest number for any continent. In a comparison of the development situation of Africa with that of South Asia, Collier and Venables argue persuasively that fragmentation into many small economies can explain much of the poor African development performance and the costs inflicted on Africa's citizens.[18]

Fragmentation is associated with an uneven distribution of natural resources, the absence of scale economies in the production and delivery of goods and services in small markets and the impact of scale on the cost of public goods and infrastructure services. The phenomenon of fragmentation and small markets is shown comparatively in Table 1. In 2008, 12 African states had populations of less than two million while 20, all of them in SSA, had a gross domestic product (GDP) of less than US$5 billion, of which no fewer than seven had a GDP of less than US$1 billion – indeed tiny economies. By comparison, the Republic of Ireland, a small EU member state,

[17] Robinson, Potential Gains from Infrastructural and Natural Resource Investment Coordination in Africa, in: Teunissen (ed.), *Regionalism and the Global Economy The Case of Africa*, 1996, p. 68 (68).

[18] Collier/Venables, Trade and economic performance: Does Africa's fragmentation matter? Annual Bank Conference on Development Economics, Cape Town, South Africa, memo 2008.

had a GDP of US$ 281.8 billion, which exceeds that of the largest African economy, South Africa. If South African production is excluded the combined GDP of the remainder of SSA comes to US$720 billion, which is 16% less than the GDP of the Netherlands, a mid-sized European economy. Bearing in mind the changing pattern of growth in international trade and the role that a small number of developing countries have in this, it may be noted that one of the rising stars of the new trade environment, India, has a population of 1,140 million, which is substantially larger than that of SSA's 819 million. The GDP of India is 22% larger than that of the whole of SSA, South Africa included.

It is within this context that the rationale of regional economic integration should be explained, a justification that can be summarised in a number of framework propositions.

- To develop, diversifying economic growth is required, and in this context industrialisation is ultimately the driving force.
- Economies of scale in production matters in determining competitiveness. Given small and poor markets it follows that production cannot grow if countries try to produce goods that are primarily to be sold in the domestic market. According to Gary Fields a fundamental truth has to be considered: "if you're poor you can't get rich by selling to yourself".[19]
- From the second proposition it follows that production for export is required to boost economic growth and development.
- Considering the current production base of African LDCs it is unlikely that many of these economies will be in a position to replicate the development experience of Mauritius, an African economy that has been successful in converting a primary-producing economy into one that has grown rapidly on the basis of manufactured export production.
- If it is accepted that rapid export-oriented industrial growth that targets the global market is not a viable route to escape the constraint of small domestic markets and the absence of scale economies, production for export to the regional market presents itself as a growth opportunity. It is even possible to argue that this will allow export producers not only larger scale economies but also the opportunity to develop export skills in a more familiar and less onerous market environment than what exists in the large markets of the industrialised world and the fast-growing developing countries.
- Consequently, removing barriers to trade in a region through the conclusion and implementation of RIAs presents itself as a necessary development approach. It follows that growth in intra-regional trade will serve as an indicator of successful market integration.

It must be emphasised that regional economic integration and a focus on production for the regional market can only be a first step in providing sustainable growth opportunities. In the long run integration into the global market and all this

[19]Fields, The Employment Problem in South Africa, Trade & Industry Monitor 16 (2000), p. 3 (4).

requires remains an imperative. An implied message of Table 1 is that if a group of very small and poor neighbouring economies are integrated, the integrated market remains small by world standards. However, in incremental terms any enlargement of the market for these economies is an improvement – also in achieving scale economies – on no enlargement through market integration.

Post-Colonial Experience

When African countries entered independence during the 1960s the overriding economic objective was rapid industrialisation that would allow them to catch up with the industrialised world. A number of crucial tenets were encapsulated in the view on development that prevailed at the time: industrialisation and the power this gives the nation state are indispensable, the state and state planning are important, the collective ownership of the factors of production is legitimate, and the industrialised market economies exploit developing countries. In the words of Landes: "...Third World development economics ... bore a strong resemblance to its intellectual predecessors of the nineteenth century (Hamilton, List et al.), but modified, first by Marxian notions of the primacy, indeed the indispensability, of industry; of the superior if not sole legitimacy of government or collective ownership of the means of production, including peasant land; and of the importance of state planning and intervention; and second, by post-Marxian concepts and grievances of international exploitation and the penalties of inequality".[20]

This view of development and the appropriate development approach found support in development-oriented market integration as an instrument of industrial development. During the 1950s and 1960s import substitution was regarded as the most appropriate way to industrialise and if a larger protected market could be created through regional integration, more opportunities for viable import-substituting industrialisation were possible.[21] In the Western hemisphere inward-looking growth through import substitution in the larger integrated regional market was strongly propagated by the UN Economic Commission for Latin American and its Secretary General, the prominent Latin American development economist,

[20] Landes, Why Are We So Rich and They So Poor?, American Economic Review, Papers and Proceedings, 80 (1990) 2, p. 1 (6).

[21] The support for import substitution was based on the theoretically valid argument of infant industry protection combined with a prevailing attitude of export pessimism. The contention was that the competition of established industries in the developed countries would restrict developing country exports. Also, it was believed that the market of the developed world could not absorb and sustain the growth in labour intensive manufactured imports from the larger developing world. Domestic industries with a potential comparative advantage could "during the temporary period when domestic costs in an industry are above the product's import price" be given tariff protection, which would be "socially desirable method of financing the investment in human resources needed to compete with foreign producers". (Baldwin, The Case against Infant-Industry Tariff Protection, Journal of Political Economy 77 (1969), p. 295 (296–7)). Dynamic externalities embodied in learning-by-doing will allow the firm to become competitive during its phase of "infancy".

Raul Prebisch. Diverting trade from cheaper sources in the world market to higher-cost, protected producers in the regional market might immediately lower welfare but in the long run the industrial growth this was expected to bring about was seen as justifying the short term welfare cost.

Although import-substitution featured prominently in the initial thinking on regional integration in Africa, it has been argued that "import substitution did not fail in Africa, rather it was never really tried".[22] The intention in Africa was not to proceed incrementally in protecting and developing labour-intensive industries on the basis of the conventional infant industry argument, but rather to establish simultaneously a wide range of industries across different sectors. Replicating the economic structures of developed countries was the guiding principle in contrast to incremental import-substituting industrialisation. However, the fact remains that many African countries during the first years of independence followed a route of severe interventionism to protect domestic industry as part of an industrialisation strategy aimed at replacing imports with domestic production.[23]

Economic integration and the desire to industrialise culminated in the Lagos Plan of Action (LPA), adopted in April 1980 as a special initiative of the OAU Heads of States and actively promoted by the UN Economic Commission for Africa (ECA). The LPA emphasised the contribution expected of industrialisation by designating the 1980s as the "Industrial Development decade in Africa", thus emphasising the contribution expected of industrial development as an African growth force. From the perspective of regional integration, an important contribution of the LPA framework for industrialisation was the division of the economic space of Africa into regional integration areas that would provide the eventual building blocs of a united African economy. To achieve this the ECA sponsored three regional integration arrangements covering three sub-regions: the Economic Community of West African States (ECOWAS) for West Africa, which having been established in 1975 predated the LPA; the Preferential Trade Area (PTA) covering East and Southern Africa, which is the predecessor of the Common Market for Eastern and Southern Africa (COMESA); and the Economic Community of Central African States (ECCAS) for Central Africa. The Arab Maghreb Union (AMU) was established in 1989, thus completing the coverage of the continent, excluding apartheid South Africa. But apartheid came to an end and in anticipation of democratisation in South Africa, the Southern African Development Coordination Conference (SADCC), established in 1980, was transformed into the Southern African Development Community (SADC) in 1992. South Africa joined SADC in 1994 and in so doing became embraced in the continent-wide effort to integrate markets.

[22]Bruton, A Reconsideration of Import Substitution, Journal of Economic Literature XXXVI (1998), p. 903 (918).

[23]United Nations Conference on Trade and Development, *Economic Development in Africa Report 2009 – Strengthening Regional Economic Integration for Africa's Development*, 2009, p. 8.

In reviewing the African regional integration experience before and after the adoption of the LPA a few anomalies can be identified. First, much has been made of the goal of self-reliance and consequently the adoption of inward-looking, import-substituting industrial development strategies. Above it has been noted that there is an interpretation that denies that import-substitution as a coherent strategy was really applied in Africa; the intention was rather to replicate the structure of modern industrialised economies over the spectrum of economic sectors. However, protectionism applied with the intention of achieving self-reliance and in this sense import substitution was intended.

A second anomaly is that protectionism applied to national economies and not to integrated regional markets. Efforts to replace imports applied to domestic markets and not to the common customs area of a regional market. Import substitution within a regional market is best served, from a policy perspective, by the region being a customs union with its common external tariff. This would allow room at the supra-national regional level to design and implement a trade and industrial policy that aims to replace imports into the common customs area with goods produced in the region through the use of selective protection based on the infant industry argument. Even to date customs unions with common industrial policies do not exist in Africa.

A third anomaly concerns the policy experience of the mid-1980s, following the adoption of the LPA, which saw individual African countries implementing trade liberalisation strategies as part of structural adjustment programmes inspired by the World Bank and the International Monetary Fund. Consequently, coordinated regional development envisaged by the LPA was stalled.

African Union

Trade liberalisation and structural adjustment at the national level did not prevent African countries from professing adherence to the regional approach to development and African unity. Regional integration was given further impetus with the adoption in 1991 of the Abuja Treaty, which called for the establishment of the African Economic Community (AEC) by 2027. The Treaty has been described as "articulated around the concepts of solidarity and collective self-reliance: a self-sustaining and endogenous development strategy; and a policy of self-sufficiency in basic needs".[24] It envisages an African central bank, a common currency, complete mobility of the factors of production and the free movement of goods and services among African countries. In 2001 the political momentum of regional integration increased when the Constitutive Act of the African Union (AU) entered into force. The AU was formally launched in April 2002 at a summit meeting in Durban, South Africa.

[24] African Development Bank, *African Development Report 2000*, A Summary, Regional Integration in Africa, 2000, p. 11.

The AU replaced the Organisation of African Unity (OAU), which was established in May 1963. Whereas the OAU in principle tended to be a political organisation, the AU is portrayed as an organisation aimed at economic integration and social development that would eventually lead to political integration. Although the AU definitely attaches more importance than the OAU to economic development through economic integration, the political spirit of Pan-Africanism remains alive, as revealed in the address of the chairman of the AU when it was launched, stating that the "first task is to achieve unity, solidarity, cohesion, cooperation among peoples of Africa and African states".[25] Within this context the commitment to regional integration can be seen as "part and parcel of the broader aspiration of continental integration, which takes its roots from the Pan-African movement of shared values, collective self-reliance in development and political independence".[26]

Southern Africa as a Building Bloc of an Integrated Africa

As noted earlier an important facet of the LPA is the architecture it envisaged of a continent divided into regional integration arrangements that eventually could form the building blocs of a united Africa. In this way provision was made to achieve the end-goal of an African Union. In other words, the African Union will eventually come about by using separate sub-regional economic communities as the building blocs of the continental union. In addition, the RIAs are set to achieve this goal by adopting the linear model to deep levels of integration. Of 11 major RIAs, eight have a full economic union as specified objective, while one aims to develop a common market (COMESA) and one (SACU) has been a customs union since its establishment and has no declared intention of deeper integration.[27]

The integration organisations in southern Africa serve as useful illustration of the African regional integration paradigm. They also reveal the difficulties experienced in adapting to changing circumstances.

The wider and all-embracing RIA in southern Africa is SADC with its 14 member states. Of these countries five form a customs union, SACU, which is an excise union as well, while four of the SACU member states – Botswana being the only exception – belong to the Common Monetary Area (CMA). As noted earlier eight SADC countries are also members of COMESA.

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[25]President Thabo Mbeki, Launch of the African Union, 9 July 2002: Address by the chairperson of the AU, accessed at http://www.africa-union.org/official_documents/Speeches_&_Statements.

[26]United Nations Conference on Trade and Development, *Economic Development in Africa Report 2009 – Strengthening Regional Economic Integration for Africa's Development*, 2009, p. 8.

[27]United Nations Conference on Trade and Development, *Economic Development in Africa Report 2009 – Strengthening Regional Economic Integration for Africa's Development*, 2009, p. 10.

It is tempting to see this constellation of organisations as a planned experience of multiple speed integration over time. But this would be misleading since SACU (and the CMA) pre-dates SADC. The establishment of SACU in 1910 and its development since then is deeply imbedded in the colonial history of a common customs area that was formally managed in terms of agreements that had to accommodate the de facto economic integration of separate political entities. Initially these included the Union of South Africa and the three British High Commission Territories of Basutoland, Bechuanaland and Swaziland, which in the latter half of the 1960 became the independent countries of Botswana, Lesotho and Swaziland. Namibia, the earlier South West Africa, joined SACU when it became independent in 1990. South West Africa had been entrusted to South Africa by the League of Nations to be governed as a so-called C Mandate.[28] South Africa effectively governed Namibia as the "fifth province" of South Africa, which meant integration into the South African political system, as well as integration into South Africa's communications and transport infrastructure and services and goods markets.

SACU is a customs union of economic unequals. South Africa, with 87.3% of the SACU population, contributes 92.2% of the SACU gross domestic product, 95% of manufactured output (value added) and 86% of merchandise exports.[29] Until the 1969 SACU Agreement came into force the customs union provided for free trade between members and the sharing of customs and excise revenue on the basis of fixed percentage shares. The 1969 Agreement between South Africa and the three newly independent countries acknowledged the unbalanced nature of the customs union, inter alia by sharing revenue through a formula that transferred revenue to the smaller member states in excess of what they would receive on the basis of a proportional share in the revenue generated though customs and excise duties. But like under the 1910 Agreement, policy decisions with respect to tariff and excise duties, as well as the administration of the customs union remained in the discretion of the South African authorities. Decisions on the import tariff were based on their relevance to South African industrial development.

The multiplied revenue share was seen as compensation for the loss of policy sovereignty, as well as for the trade diversion and polarisation effects associated with being in a customs union with a much larger economy that protected its domestic industries. Although the revenue distribution formula has been changed the element of compensating payments, which effectively represents unconditional revenue transfers to Botswana, Lesotho, Namibia and Swaziland (BLNS) was maintained in the 2002 SACU Agreement, especially as far as the customs component of the revenue pool is concerned.[30] But the new Agreement, which became

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[28]A "C" Mandate, in contrast to A and B Mandates, provided for the substantial integration of the area into the country to which the mandate was given.

[29]Calculated from data published in World Bank, *World Development Indicators 2009*.

[30]For Lesotho, Namibia and Swaziland customs revenue are crucial, especially for Lesotho and Swaziland that receive up to 60 per cent of recurrent revenue from the SACU revenue pool.

operational in 2004, introduced a radically different approach to the management of the customs union, by transferring the management by South African agencies to supra-national SACU institutions provided for in the Agreement.

The existence of SACU as a fully functional customs union pre-dates the post-colonial experience of African states by many decades. Although the customs union has had a unique development history, which means that it cannot be replicated elsewhere on the continent, the amendment and implementation of the system of management provided for in the 2002 Agreement illustrate the difficulties experienced in designing and implementing management structures when a RIA moves to deeper levels of integration, especially if the member states are unequal in size and level of economic development.[31]

Until 2004, when the 2002 SACU Agreement became operational, the CET and trade remedies such as anti-dumping action were managed by the South African Government in the interest of South African industrial development. Tariff amendment and trade remedy investigations were undertaken by South Africa's International Trade Administration Commission (ITAC) and its predecessors, with recommendations made to the Minister of Trade and Industry who on approval would refer the recommendations to the Department of Finance for implementation. Although the BLNS governments were given the opportunity to comment on investigations, the response has in general been meagre and for all practical purposes the SACU tariff represented an instrument of South African trade and industrial policy, firmly located within South Africa's policy space.

Letting South Africa manage the customs union relationship was maintained after the independence of Botswana, Lesotho and Swaziland and eventually also Namibia. It can be hypothesised that this system suited BLNS because they received financial compensation and it allowed them an "at-arms-length" relationship with apartheid South Africa. The likelihood of any group of independent countries organising a RIA, accepting a system according to which the largest economy in the group manages the CET, is so small that it can be ignored. The establishment of a supra-national organisation to manage the CET will be an imperative, forcing each member state to sacrifice some policy space.

At this point the dilemma of SACU and its new management system becomes clear, also elucidating the problems to be expected in the *de novo* planning of a customs union. At the time of writing, 6 years after the new Agreement became operational, crucial organisations provided for in the Agreement have yet to be established. The first is the Tariff Board that will consider submissions by the agencies (National Bodies) of the member states on all issues pertaining to tariff amendments, including trade remedies and duty rebates, for recommendation to the Council of Ministers, the supreme governing body of SACU. The second organisation is the *ad hoc* Tribunal that will have to deal with disputes. ITAC has in the

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[31]The 2002 Agreement is reviewed in McCarthy, The Southern African Customs Union in Transition, African Affairs 102 (2003), p. 605 (605–630).

mean time been requested by the Council to maintain its functions of tariff management until the Tariff Board has been established.

Three reasons may be suggested for the lack of progress in establishing the SACU institutions. First, there appears to be lack of capacity to expeditiously set up the required National Bodies in BLNS, supported by a perception that the revenue produced by the customs union is more important for these countries than the use of the tariff as an instrument of trade and industrial policy. Second, sight should also not be lost of the fact that a more democratic structure for customs union decision-making will negate an important part of the smaller member states' claim on financial compensation in revenue distribution. Third, the South African authorities are more concerned with the tariff as an instrument of industrial policy and it is difficult for the industrially most advanced member state to sacrifice sovereignty over this instrument, especially at a time that fundamental changes to the country's trade and industrial policy are contemplated.

The CMA, which complements SACU, is not a conventional monetary union. It can be described as a regional monetary arrangement in which the reserve currency, the South African rand, is that of the region's economic hegemon. The anchor of macro-economic stability in all member states resides in the sound monetary management by the central bank of the dominant economy, that is, the South African Reserve Bank. The currencies of the smaller member states – Lesotho, Namibia and Swaziland (LNS) – are pegged against the South African rand at par. The rand circulates as legal tender alongside the national currencies of LNS; the latter currencies are not legal tender in South Africa but are increasingly being accepted as means of payment in the border towns of South Africa. The close monetary integration between LNS and South Africa and the format in which this exists, means that the South African central bank not only has the responsibility for the monetary policy of South Africa but by extension also of the CMA. Apart from the macro-economic stability offered by the CMA the absence of any exchange risks with respect to trade and investment is also a major benefit.

Botswana left the Rand Monetary Area, the predecessor of the CMA, in 1976. The pula was introduced as sole legal tender in Botswana in August 1976. Exchange rate policy, with its focus on stability in the real exchange rate vis-à-vis the currencies of Botswana's major trading partners, has been designed to keep the country's inflation rate in line with the weighted average of the trading partners' inflation rates. Currently, the pula exchange rate is determined by a crawling peg system. Small adjustments are continuously made to the exchange rate against a basket of currencies – the rand and SDR – to allow the pula to move in line with expected future inflation rate differentials. The weights of basket currencies, which are not publicly disclosed, are determined in part by the share of bilateral trade with the respective countries.[32] In view of the fact that about 70% of Botswana's imports are sourced in South Africa and furthermore that diamond exports are not

[32]Masalila/Motshidisi, Botswana's exchange rate policy, BIS Paper 17 (2003), p. 122 et seq. (124), accessed at http://www.finforum.co.za/regional/bispap17o.pdf.

considered since they are seen to be insensitive to exchange rate fluctuations, it can be assumed that the basket is biased in favour of the rand. This is also revealed when the close link between the pula/rand exchange rate movements are traced over time.

SACU members all belong to SADC within which the customs union and the CMA represent deeper integration. SADC was founded in 1992 as a transformation of its predecessor, the Southern African Development Coordination Conference (SADCC). SADCC was established in July 1981 by the governments of nine majority-ruled countries in southern Africa with the principal objective of reducing their dependence on minority-ruled South Africa's transport and communications network, export and import trade, and employment of migrant workers.[33] The original SADC Treaty was signed by the nine members of SADCC plus Namibia in August 1992 in anticipation of democratisation in South Africa and the admission of the latter as a member state. Majority rule in South Africa effectively removed the rationale of SADCC as a cooperation arrangement seeking economic independence of the apartheid state. Consequently, SADC became a market integration arrangement with an explicit economic integration agenda.

SADC operates on the basis of a clear roadmap, stipulated in a Regional Indicative Strategic Development Plan. In the spirit of the linear integration model this plan provides for a fully operational free trade area by 2008, a customs union in 2010, a common market in 2015, monetary union in 2016 and the introduction of a single currency in 2018. At a recent (2009) meeting of the SADC Council of Ministers it was decided to postpone the establishment of the customs union. This will undoubtedly have knock-on effects on the remainder of the road map.

From the discourse and pronouncements on regional integration in the region it is clear that integration is seen as a step-wise process where each successive step depends on the previous one having been achieved. In adopting this approach the SADC roadmap reflects the general tendency to adopt the linear model of regional integration in Africa, characterised by the ambitious end goals noted earlier.

A recent development brings together the building bloc hypothesis, the phenomenon of overlapping membership and the linear model. This is the tripartite effort by COMESA, the EAC and SADC to integrate the three regional economic communities into a single integrated market. In October 2008 a summit of the heads of state and government of the member states was held in Kampala, Uganda, resolved "that the three RECs (regional economic groupings) would immediately start working towards a merger into a single REC with the objective of fast tracking the attainment of the African Economic Community".[34] The regional economic groups are recognised by the African Union Constitutive Act and the Abuja Treaty

[33]Oosthuizen, *The Southern African Development Community – The organisation, its policies and prospects*, 2006, p. 59.

[34]The COMESA-EAC-SADC Tripartite Summit of Heads of State and Government, Final Communiqué, 22 October 2008, accessed at http://www.africa-eu.org/.../file/COMESA-EAC-SADC_EN_221008.pdf.

as building blocs of the AEC. Representing nearly 50% of the AU membership, about 59% of its GDP and 57% of its population, the development of such an integrated market represents an important step in moving towards an integrated continental market.[35] The intention is to have a final Agreement establishing the Tripartite FTA "on a tariff-free, quota-free, exemption-free basis by simply combining the existing FTAs of COMESA, EAC and SADC" ready for signature in July 2011 and in time for its launch in January 2012.[36]

The Tripartite market integration will address the problem of multiple membership arising from the fact that 10 of the 24 countries involved are in a customs union (SACU and the EAC) and participating with the other 14 countries in arrangements that envisage the establishment of alternative customs unions (SADC and COMESA). Whether the exercise will succeed as intended is difficult to judge at this stage. However, past experience in Africa with ambitious targets not being met is a reason for concern. In the case of SADC the postponement of the customs union implementation date, the fact that three member states (Angola, DRC and Malawi) have not yet notified their compliance with the Trade Protocol to the SADC Secretariat, and the lack of clarity on whether the other member states have achieved the 85% liberalisation threshold mandated by the Protocol do not support optimistic expectations.[37]

The Linear Model Assessed

As noted earlier, the record of regional integration in Africa is not good. Many reasons have been given for the poor track record.[38] The intention is not to review these reasons but rather to present arguments that the paradigm adopted in African RIAs can be regarded as an underlying cause of the poor outcome. The relevant paradigm is contained in the strong focus on the linear model of integration with regional economic communities committing themselves to a step-wise and sequential development of deeper integration. The problem is that the dictates of the different phases of the linear model do not address many of the important stumbling blocks that constrain intra-regional trade and development.

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[35]First COMESA-EAC-SADC Tripartite Summit, Background Paper, 20 October 2008, p. 2, accessed at http://www.eac.int/trade/index.php?option=com_docman&task=doc...

[36]COMESA Secretariat, Brief on the COMESA-EAC-SADC Tripartite, accessed at http://about.comesa.int/lang-en/test-blog/view-all-blogs/viewpost/254.

[37]Fundira, The SADC FTA Tariff Phase-down Schedule, tralac Newsletter, 27 January 2010, can be obtained from webcontact@tralac.org.

[38]Examples of brief discussions of the reasons for the poor performance are McCarthy, Regional Integration – Part of the Solution or Part of the Problem?, in: Ellis (ed.), *Africa Now – People Policies Institutions*, 1996, p. 211 (219–221) and United Nations Conference on Trade and Development, *Economic Development in Africa Report 2009 – Strengthening Regional Economic Integration for Africa's Development*, 2009, pp. 14 – 16.

Essentially, an RIA aims to remove the barriers to trade in goods and services within a defined region. These barriers, with their negative impact on the transaction costs of trade and the cross-border supply of goods and services, might exist at the border or behind the border. The first step in the linear process, the FTA, removes the tariff as a specific *border* constraint on the free flow of goods within a region, and while it addresses an important barrier it can be questioned whether it is the most important one. While difficult to analyse systematically there is abundant anecdotal evidence that the aggravation experienced at borders is perhaps more onerous. These include "breakdowns of the electronic system for document lodging, poor coordination in the inspection of goods between different actors, overly zealous inspection of goods, insufficient opening times at the point of entry and delays in duty refunds, amongst others".[39] For some landlocked African economies the aggravation is exacerbated by the requirement of multiple overland border crossings for goods in intra-regional trade. While this constraint is likely to be more important for trade with the rest of the world there are cases within regions where intra-regional trade requires more than one border crossing. For example, within SADC shoes manufactured in Lesotho will have to be transported through three border crossings if destined for the Zambian market.

A first point to note is that in the linear model the initial emphasis falls on free trade in goods. Free trade and customs union agreements *per se* do not cater for services. In trade, services play a dual role. In the first place trade in services has become a substantial component of international trade. But services also serve a complementary and supporting role to trade in goods. Trade in goods cannot take place without supporting commercial, financial, professional and transport and communication services.

'Behind the border' constraints exist in African economies that increase the transaction costs of trade and affect the flow of labour and capital. These obstacles often exceed in severity the constraint of border barriers. Transport costs feature as a crucial barrier with econometric estimates finding that these costs in Africa are 136% higher than in other regions.[40] Trading goods internationally incur transport costs that include an international component as well as domestic transport costs (to the point of exit or from the point of entry). Geography plays a role in this regard since the limited availability of navigable inland waterways in Africa and the cheap transport this allows, restricts transport alternatives. Given this drawback, high transport costs in Africa are ascribed to distance, being landlocked, insufficient economies of scale in production, lack of investment in infrastructure, and inappropriate transport policies such as the protection of inefficient monopolies.[41] Part of the problem is historical with transport systems having been designed in colonial

[39]United Nations Conference on Trade and Development, *Economic Development in Africa Report 2009 – Strengthening Regional Economic Integration for Africa's Development*, 2009, p. 39.

[40]United Nations Conference on Trade and Development, *Economic Development in Africa Report 2009 – Strengthening Regional Economic Integration for Africa's Development*, 2009, p. 38.

[41]Naudé/Matthee, The Significance of Transports Costs in Africa, UNU-WIDER, Policy Brief 5, 2007, p. 1 (2).

times to transport primary products to port, resulting in poorly developed cross-country connections.[42]

In addition to transport costs there are also non-border barriers to trade that manifest in what is referred to as the business environment and the direct costs that effect trade. Comparisons of the number of documents needed for exports and imports respectively, the time required to export and import (in days) and the dollar cost per container of exports and imports show that SSA is significantly worse off than any other developing region.[43]

Furthermore, the lack of skills and capital to establish and operate sophisticated modern communication systems, combined with small business communities as a market that do not justify financially viable business publications, mean that business news and information required for informed decision making is not readily available.[44] Fixed-line telephone services are restricted and call charges, especially for international calls, are notoriously high in most African economies where the provision of fixed line services is often restricted to public monopolies. Information is the lifeblood of market transactions and if not readily available at reasonable cost, market efficiency suffers because of the bloated or hidden transaction costs of trade.

Although these barriers also constrain trade with the rest of the world, their impact on trade in the region is particularly pernicious. Current patterns in the direction and composition of trade referred to earlier are maintained since in Africa information on industrialised markets is more readily available than information on business opportunities in the neighbouring countries. The lack of readily available information, high regional transport and communication costs and poor transport links make it relatively costly and difficult to do business in the region and to sacrifice the ease of maintaining established business contacts with suppliers and buyers in a few industrialised markets.

The relevance of identifying the different barriers to trade becomes obvious once it is taken into account that a free trade agreement or a customs union as formal arrangements by definition only addresses one barrier, the import tariff. There is no reason why a free trade or customs union arrangement should not also include elements that address other trade barriers but in the real world of regional integration where the roadmap is derived from the linear model, attention focuses on

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[42]McCord/Sachs/Woo, Understanding African Poverty: Beyond the Washington Consensus to the Millennium Development Goals Approach, in: Teunissen/Akkerman (eds.), *Africa in the World Economy – The National, Regional and International Challenges*, 2005, p. 23 (37).

[43]United Nations Conference on Trade and Development, *Economic Development in Africa Report 2009 – Strengthening Regional Economic Integration for Africa's Development*, 2009, p. 38 (Table 8).

[44]Collier and Venables argue that large societies can be better informed than small societies because of the existence of scale economies in the commercial media. They mention that in Africa only "South Africa comes anywhere close to providing a market in which specialist journals are viable"; Collier/Venables, Trade and economic performance: Does Africa's fragmentation matter? Annual Bank Conference on Development Economics, Cape Town, South Africa, memo 2008, p. 30.

schedules that over time will remove the "duties and other restrictive regulations of commerce" on "substantially all trade" in the case of an FTA and in the case of a customs union on the design and implementation over time of a common external tariff.[45] The other barriers require efforts by participating governments that go beyond what is conventionally provided for in these integration arrangements. Removing the non-tariff barriers in many instances also does not require a regional integration arrangement; they can only be addressed adequately through concerted national efforts.

To remove the tariff as a border barrier by establishing a free trade area is the first formal, WTO-compliant step in launching a process of regional integration. Experience has demonstrated that even this first step is a difficult and often time-consuming process, a process that only addresses what in any event is likely to be a lesser barrier to trade. Taking the next step of the linear model by establishing a customs union brings forth new problems, aptly demonstrated by the experience of SACU in establishing customs union institutions. Apart from the complexities of designing and implementing an acceptable CET, supra-national institutions and management practices must be put into place to manage a common tariff. If the planned tariff structure is simple in design, say a four band tariff, and the categories of tariff lines sensibly demarcated, the management of the customs union tariff might not raise many problems.[46] Again, it needs to be noted that difficult changes have to be made without a commensurate return in reduced non-tariff trade barriers.

At issue here is the capacity to proceed with deeper market integration as envisaged in the linear model. Progressively deeper integration cannot be achieved by poor economies (after all, integration arrangements and their management demand substantial resources in terms of money and skills) that tend to design and implement poor policies and have weak institutions in place. To construct a well-organised and effective regional community, the building blocks, that is, the member states must be solid. It is a fallacy to believe that an ambitious road map of regional integration can be implemented and managed effectively by states that are weak in policy, governance, and institutions.

The issues discussed thus far often feature in reviews of constraints to regional trade. Many of these problems are expected to be solved by trade facilitation programmes. But what needs to be emphasised is that the removal of the non-tariff barriers to trade does not require a formal regional trade arrangement and even at the border aggravation cost may be more significant than the tariff. Also, the relevance of an RIA becomes even more questionable if attention shifts to the supply-side capacity of the typical SSA economy to produce goods and services that can be traded in the region. This seems to be the proverbial elephant in the room that is often ignored or merely not recognised.

[45]The General Agreement on Tariffs and Trade 1947, Article XXIV.8, in: World Trade Organization, *The Legal Texts of the Uruguay Round of Multilateral Trade Negotiations*, 1999, p. 423 (460).

[46]What needs to be considered is that in Africa trade taxes are an important source of revenue and consequently the collection and distribution of customs revenue could prove a problem.

Improved market access through regional integration without the commensurate capacity to produce goods and services will inevitably fail to produce the growth hoped for. In other words, a larger integrated market in which goods can be traded at lower transaction costs will come to naught if the ability to produce goods for the expanded market does not exist. The inverse of Say's Law, namely that 'demand creates its own supply', does not apply in economies that lack dynamic business cadres, adequate infrastructure, good institutions and skilled labour.

Many of the recognised constraints to the growth of the majority of SSA economies are found on the supply-side of economic activity, that is, in building a business sector that can respond to improved market access by investing in the production of tradable goods and services. Challenges in this regard include the following: sound domestic macro and micro-economic policy choices; improved governance; development of institutional capacities; investment in infrastructure and in the supply of public goods; and the development of a business environment that will allow a business sector to develop and invest, including the attraction of foreign direct investment. While formal market integration can contribute to strengthening the supply side, a national effort will in the first place be required.

Conclusion

The consensus is that, thus far, African economic integration has not been successful. This, however, has not diminished the enthusiasm for integration on a grand scale, leading to continental integration in two decades' time. Questioning the realism of the approach to integration in Africa does not mean that the merit of economic integration is denied. In fact, a critical assessment of a paradigm of strict adherence to the linear model of integration with ambitious roadmaps of sequential institutional arrangements, combined with a consideration of the barriers to intra-regional trade and economic development that are not addressed by removing tariff barriers to intra-regional trade, could in the end benefit regional integration and development.

A realistic commitment to regional integration requires not only expanding market access by removing tariff barriers but a more holistic approach that will emphasise efforts to overcome other barriers to trade within and at the borders of national economies, including the ultimate barrier of not having the capacity to produce tradable goods. Compared to non-tariff barriers and the supply capacity constraint, import tariffs may only be a minor constraint to regional trade. The development of transport links through coordinated investment in transport infrastructure (road, rail and port facilities), investment in communication services, and the standardisation and simplification of customs procedures at borders could have a substantial impact on the transaction costs of regional trade, thus complementing tariff liberalisation in encouraging trade. Furthermore, growing trade requires the development of production capacity through institution building, good and corruption-free governance, skill development, allowing and encouraging the

development of an entrepreneurial corps and a vibrant private business sector, and encouragement of private investment (both domestic and foreign direct investment) in production capacity, the elimination of red tape, and in general the creation of an environment that is business friendly and characterised by macro-economic and political stability.

Regional cooperation and formal integration arrangements can contribute to development through intra-regional trade, but they should be modest in design and supported by a strong commitment on implementation. However, sight should not be lost of the fact that a bottom-up approach that starts with sound national development efforts is a necessary condition for regional integration to realise its full benefits. The various regional economic groups will only serve as effective building blocs of an integrated continent if they in turn are made up of well-managed member states.

Regional Integration in Latin America: Some Lessons of 50 Years of Experience

Félix Peña

The Evolution of Latin American Regional Integration

The 50 years that have elapsed since the birth of the formal processes of Latin American integration provide an opportunity to reflect upon its future. The new international context that is manifesting itself with the current global crisis incites us to approach this task.

At least two different stages in the development of regional integration can be distinguished during the last five decades. All facts indicate that a new stage is beginning now. Its scope and characteristics have yet to manifest themselves to their full extent.

As a strategic concept, the precedents of regional integration date back to the nineteenth century. However, the first phase of concrete achievements began to manifest itself with the negotiation and signature of the Treaty of Montevideo in 1960 – a result of the initiatives and negotiations of the preceding 2 years – which created the Latin American Free Trade Association (LAFTA). [1] The addition of Mexico, not foreseen in the original proposal, which was South American in scope, extended this initiative of commercial integration to the Latin American space. Simultaneously, Central American countries were resuming their own process of subregional integration which had strong historical roots.

A second stage of regional integration began with the transformation of LAFTA into the Latin American Integration Association (LAIA) through the treaty that was also signed in Montevideo in 1980. It was the result of the confirmation that a free trade zone between numerous countries – at the time less connected and more distant than today – with considerable asymmetries in size and level of development was nonviable. In a way, the creation of the Andean Group with the signing of the Cartagena Agreement in 1969 was the first manifestation of this fact. In this

[1] Dosman, *The Life and Times of Raúl Prebisch – 1901-1986*, 2008, pp. 337–345.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_16, © Springer-Verlag Berlin Heidelberg 2011

sense, what happened with LAIA constitutes a precedent of what was later confirmed by the failure of the initiative for a Free Trade Area of the America's (FTAA), which was still more extensive.

However, the transformation of LAFTA into LAIA had a deeper meaning, which was to accept that the existing differences required partial approaches, of multiple speed and variable geometry. This meant the recognition of the reality of different subregions and sectors whose interdependence and interests were not necessarily shared by all countries. The original approach of LAIA, according to which the regional instruments were the rule and the subregional and sector ones the exception, was reversed: what was of a partial scope – a group of countries or given sectors – became the main rule and the regional scope became, at the same time, the framework and the final objective, though not a well-defined one in its contents or deadlines.

This stage opened the way to deep transformations in the regional integration strategy which matured in the following years. Furthermore, in contrast with the preceding stage, a greater responsiveness to the differentiated demands presented to the Latin American countries by the new international reality could be evinced from the 1980s and particularly the 1990s. The consequences of this were differentiated answers in the area of international trade policies and negotiation strategies.

During this new stage that reaches into the present, among other relevant facts, the Andean Group became the Andean Community of Nations (CAN) in 1997; the bilateral process of integration between Argentina and Brazil was initiated (1986), with a special emphasis on particular sectors such as the automotive sector; Mercosur was created in 1991; Mexico concluded the North American Free Trade Agreement with Canada and the USA in 1994; and the process of bilateral preferential trade agreements began to materialize with countries in the rest of the world, starting with the USA and the European Union. In addition, an interesting precedent that reconciles the integration of a regional geographic space with third parties through preferential trade agreements was born. Such a precedent was the result of the free trade agreement between Central American countries, the Dominican Republic and the USA (CAFTA-RD).

The changes that were simultaneously taking place in the global context had a strong impact on the beginning and evolution of the first two stages of Latin American regional integration. In the last two decades, the post-Cold War reality translated into a multipolar economic competition, and the USA changed its global commercial strategy driven by its own network of preferential agreements. This, together with the enlargement of what would become the European Union, the growing prominence of emerging economies and re-emerging ones, such as China, the conclusion of the Uruguay Round and the creation of the World Trade Organization (WTO), and the development of production networks and transnational supply chains were, among others, some of the factors that deeply altered the external environment in which the Latin American and, particularly, the South American integration developed.

In addition to these, there are deep economic and political transformations – also of a differentiated reach – that have taken place in the region and in each of the

countries. The South American scene, in particular, displays a denser interconnection between its productive systems, including the energy field. Several countries have undergone a remarkable evolution in their experiences both in the economic aspect as well as in the political plane. The relevant role that Brazil has taken on is a significant fact that marks the difference between what the region was before the 1990s and what it is today.

A New Phase of Regional Integration in Latin America?

Are we at the beginning of a new phase of regional integration in Latin America? There are some elements that allow us to affirm so. This new stage would be driven by several factors. The first is the emergence of a large number of options for the involvement of each Latin American country in world markets as a result of the growing number of relevant protagonists in every region and of the reduction of all kinds of distances. The second element is the fact that such options may be capitalized simultaneously. The third factor is that for most of the available options it is feasible to develop win–win strategies in terms of the trade of goods and services, of productive investments and of the incorporation of technical progresses.

However, the main factor driving the move towards new integration modalities in the Latin American regional space, as well as in its multiple subregional spaces, may be the growing discontent of some countries with the results obtained from the processes currently under way. This is evident in the case of CAN as well as in the case of Mercosur.

Such dissatisfaction may bring about at least two possible scenarios which may prove disadvantageous and unsuitable to meet the challenges that are faced at a global scale. The first scenario is that of a kind of "integration inertia". This would imply continuing along the lines of what has been done until now, that is with no major innovations. The risk of this scenario is that the integration process may become irrelevant for certain countries. In such a case, the end result could be the predominance of the mere appearance of an increasingly obsolete integration system with a low bearing on reality. The second scenario is that of a "foundation syndrome". This would imply casting aside what has been accumulated until now in terms of joint regional strategy and preferential economic relations – in the case of Mercosur and CAN it is much – and attempting to start all over again.

There is, however, a third possible scenario. This would probably be the most convenient and, in any case, it would be feasible. This would be to capitalize on the cumulative experiences and results, adapting the strategies, goals and methods of integration to the new realities of each country, of the region and its subregions and of the world. Such adaptations seem all the more necessary in the subregional agreements, such as Mercosur and CAN, than in broader frames such as LAIA – whose role in regional trade is still current – and the new Union of South American Nations (UNASUR), which, however, has yet to prove its effectiveness.

The Main Lessons of the 50 Years of Experience

What do the cumulative experiences of the last 50 years suggest? Several meaningful lessons stand out. The first of them refers to the importance of reconciling political leadership with technical reliability. This implies the direct involvement at the highest political level with the layout and follow-up of the corresponding strategy and, at the same time, an adequate technical formulation in regard to the objectives and working methods. The second lesson refers to the need to consistently adapt the goals and instruments to the changing realities while preserving, at the same time, a certain degree of predictability in the rules, and the need for collective regulations that can be complied with. The third lesson is related to the importance that each country has its own national strategy in relation to the corresponding integration process. The way towards the regional dimension begins with a proper definition of the national interests of each country. This fact is corroborated by the actual experience of the past 50 years. Those countries which have a clearer idea of their interests are probably those which have profited the most from integration agreements. In addition, this constitutes a safeguard against a sort of "integrationist romanticism" by which what has been called "hypothetical supranational rationalities" constitutes the driving force of any given regional process.

What factors can explain the persistent distance between what is agreed and what is achieved in terms of Latin American regional integration? One of them has been to set ambitious goals that clash with reality. There are other motives too, both political as well as economic. However, we would like to focus on one circumstance in particular that has been present since the inception of LAFTA in 1960. This factor marks the difference with the European experience and with that of other regions, such as North America, first with the initial free trade agreement signed between Canada and the USA and later with NAFTA, which also included Mexico.

We are referring to the precariousness of the legal commitments entered into, reflected by the idea that these are to be complied within the measure that is possible and which are unilaterally cast aside if the economic realities demand this. This factor weakens the essence of this type of agreement, which is to provide a kind of insurance against any discretionary protectionist measure that may be incurred by a partner when it considers that the circumstances call for it.[2] This potential for a discretionary unilateral protectionism could have a dissuasive effect on firms planning to invest for the enlarged markets particularly in the smaller member countries of a regional integration process.

One way of supporting such insurance against protectionism is the mechanism for the solution of controversies, which can be used as a resource by member countries when they consider that non-fulfilment of its obligations by another

[2]Bergsten, Globalizing Free Trade, Foreign Affairs 75 (1996) 3, p. 105; Mikic/Ramjoue, *Preferential Trade Agreements: An Insurance Against Protectionism?*, 2009.

member country has affected their domestic interests. It has proven its efficiency within the WTO and NAFTA. It is available in Mercosur, though it is not frequently used by its members. Another possibility is the different safeguard mechanisms or escape clauses that can be introduced into an agreement. These are non-existent in Mercosur, except for a version called the "competitive adaptation mechanism" within the bilateral relation between Argentina and Brazil, currently not in use.

But since the time of the creation of LAFTA, in the event of any non-fulfilment the partners have chosen to resort to two main modalities that are indeed practical but that contribute to undermine the agreements. One consists of compensating non-fulfilments, the other of tolerating them when it is considered that they do not affect any specific interests.

The problem is that both approaches can dilute the assumed commitments and erode the economic effectiveness of the rules of play by producing two concrete effects. Firstly, they could discourage productive investments in relation to the enlarged market. Secondly, they could benefit the country with the largest relative economic dimension and make it more attractive for investors. This explains why Canada and Mexico have made the insurance against protectionism from the USA a central issue in their strategy of regional integration.

What are the accumulated assets that need to be preserved? The first one refers to the assessment of an integration process as an essential factor for governance in terms of the predominance of peace and political stability of a determined regional or subregional geographic space. Second is the stock of already agreed economic and trade preferences which today have a bearing on trade and investments flows. Finally, the third asset is the value of certain "brands" for the international image and identity of a group of countries, as is the case with Mercosur as a "brand name".

What are the adaptations in the strategies, objectives and methods of an integration process that may result from the new international scenario and, in particular, from its most probable future evolution? The first of these is the deepening of flexible methodologies that combine variable geometry, multiple speed and a sector approach. These will not always be applicable to models of other regions or to what is indicated in textbooks. However, they may be consistent with the regulations established by the GATT/WTO legal system. The second adaptation refers to the institutions and the rules of the game. To orchestrate well-defined national interests among countries of different sizes and levels of development it would seem essential to enhance the ability to formulate common visions and interests that may be represented by organs with a certain degree of independence, at least on the technical level, from the respective governments. These would not necessarily have to follow the model of supranational institutions, such as those originated in the European experience, nor would they need to be too complex or costly. In this regard, the functions of the WTO Director-General may represent a precedent that is better suited for the national sensibilities of some Latin American countries. Finally, the third adaptation is related to the importance of having, in each country, a minimum group of firms with offensive interests in relation to the respective regional or subregional markets, which implies also a capability to create internationalization business strategies even at a global scale. This is a necessary

requirement to move forward in a relatively balanced way towards the attainment of the much valued goal of productive integration.

Perhaps the advice given by one of the characters in a novel on contemporary India by Rohinton Mistry[3] to his young occasional travel companion can be applied to the Latin American integration and its different institutions: "the secret of survival is the acceptance of change and adaptation...".

It is still difficult to visualize if the adaptation scenario will take place. However, the course of these 50 years, with its progress and frustrations, anticipates that Latin American regional integration will continue to be valued by the respective countries and by their public opinions. At least, there seems to be a consensus in that the costs of non-integration might be too high, both in economic and political terms.

This trend anticipates a forecast of winding progress, with improvements and setbacks, unorthodox but persistent, towards a greater degree of integration on every aspect – not just the economic – between the countries of the region and of its different subregions. In this sense, it is possible to imagine a greater resemblance to what has been the Asian model in latter years and, eventually, to what could be the future evolution of the European model.

[3]Mistry, *L'Equilibre du Monde*, 1998, p. 337.

Report on the ASEAN Economic Cooperation and Integration

Prasit Aekaputra

Overview The aim of this report is to trace back and analyse the legal nature of the Association of Southeast Asian Nations (ASEAN) since its birth. Presently, ASEAN is changing its nature from an "association" to an "international organization". Although ASEAN uses the model of the EU and the WTO for the new ASEAN vision 2020, their legal natures are quite different. ASEAN economic integration is still in the process of changing. The ASEAN Economic Community (AEC) was formed by ASEAN members to create a single market for the region by 2015. This new model of ASEAN will pave the way for regional economic cooperation and integration. Furthermore, it will support the expansion of trade and investment liberalization in this decade. However, it does not mean that ASEAN economic integration will undermine the WTO; to the contrary, it will facilitate the main purposes of the WTO and play a significance role in economic cooperation as a key regional organization and support the basic principles of the WTO.

The Birth of ASEAN and Economic Cooperation

ASEAN was established on 8 August 1967 in Bangkok, Thailand, with the signing of the Bangkok Declaration by the five founding nations, namely Indonesia, Malaysia, Philippines, Singapore and Thailand. [1] At the beginning, ASEAN was not an international organization because the Bangkok Declaration is not a treaty

[1]The main reason for the establishment of ASEAN was a political one because Southeast Asia was a region of turmoil and instability in the 1960s and 1970s. After the decolonization period, especially in the early 1960s, Singapore, Malaysia, Brunei and Philippines became independent states, but the colonial heritage provoked a new conflict in this region such as the Sabah dispute, the Vietnam War and the perils of the communist hegemony in Southeast Asia, all of which contributed to the necessity of the establishment of ASEAN.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_17, © Springer-Verlag Berlin Heidelberg 2011

establishing ASEAN. This declaration is simply a political instrument which aims to show the political good intention of the signatory states to cooperate more closely with one another mainly in the fields of economic, political and social cooperation, although their ambition is an extensive cooperation in which the main purposes include cooperation in technical matters, education and other fields by emphasizing the spirit of the UN Charter.

Since 1967, ASEAN has been considered as an association for regional cooperation among the countries of Southeast Asia, and most of ASEAN's activities have been of economic and political nature concerning specific problems arising from the series of political crises and turmoil in this region.

ASEAN Economic Cooperation

The first milestone in ASEAN economic cooperation was the First ASEAN Summit held in Bali in 1976. One of the most important documents derived from this summit was the Treaty of Amity and Cooperation in Southeast Asia of 1976 and the Declaration of ASEAN Concord of 1976 which set forth Bali's programme of action in the form of three political instruments of ASEAN economic cooperation: the ASEAN Industrial Projects (AIP), the Preferential Trading Arrangements (PTA) and the ASEAN Industrial Cooperation (AIC) schemes. The Declaration of ASEAN Concord of 24 February 1976 adopted the programme of action as a framework for ASEAN cooperation in six areas: political, economic, social, cultural, information and security.

In 1977, the Second ASEAN Summit in Kuala Lumpur paved the way for cooperation with the major trading partners of ASEAN, namely Australia, Canada, the European Community, Japan, New Zealand and the USA especially in the areas of political, economic, trade, development, social and cultural cooperation, including a cooperative relationship with the UN Development Programme (UNDP).

However, during the 1960s and 1970s, ASEAN economic cooperation progressed slowly owing to the negative impacts arising from the consequences of the Vietnam War and the Cambodian crisis. It should be noted also that most of the instruments of ASEAN in this period were the political instruments which have no legally binding force or may be considered as *lex ferenda* in the sense of a desired law or having some legally binding force in economic integration principles as a soft law. ASEAN countries use the legal technique in the conclusion of their agreements in the form of a declaration, joint communiqué, understanding or press release to have some freedom to exercise their sovereignty especially in domestic affairs for the sake of their own national security and benefits.[2] Therefore,

[2]Even in the case of the Treaty of Amity and Cooperation in Southeast Asia of 1976, the treaty does not provide any concrete legal measure to enforce the obligation of ASEAN economic integration. On the contrary, the provisions of this treaty allow the state parties to promote perpetual peace and cooperate in the economic, social, technical, scientific and administrative

the legal technique of soft law and political commitments became an escape clause for ASEAN countries. In this regard, this escape clause may be considered as a flexible exemption from the soft obligations of economic integration among ASEAN countries.

At this stage, the legal status of ASEAN was a cooperation entity as an association but not as an international organization. The idea of closer economic cooperation enshrined as the second milestone of economic cooperation was announced at the Third ASEAN Summit, called the "Manila Summit of 1987". This summit revitalized the ASEAN economic agenda. The five founder nations of ASEAN and Brunei Darussalam (ASEAN 5-1) agreed to carry out a package of measures to improve PTA by applying the progressive reduction of items on the exclusion list, accelerating sound industry development by making the ASEAN Industrial Joint Ventures (AIJV) scheme more flexible, quicker to implement and more attractive to private investors. Intra-ASEAN cooperation in various areas was encouraged by this summit, i.e. intra-ASEAN cooperation in the fields of finance, banking, commodities, trade in services, energy, transportation, communication, food, agriculture and forestry.

ASEAN Economic Integration

The third milestone of ASEAN economic cooperation was the Fourth ASEAN Summit in Singapore in 1992, because the result of this summit is another historical landmark of ASEAN economic integration by setting a legal mechanism for economic integration among ASEAN countries. The Singapore Declaration of 1992 adopted the Framework Agreement for Enhancing ASEAN Economic Cooperation and established the ASEAN Free Trade Area (AFTA) by using the Common Effective Preferential Tariff (CEPT) scheme as a model for the acceleration of economic integration in 15 years starting from 1 January 1993, with the ultimate effective tariffs ranging from 0 to 5%. These agreements are indeed the binding treaties between ASEAN countries to set up the AFTA in 15 years and broaden the scope of the economic cooperation to economic integration by using the process of trade liberalization and investment promotion not only in the framework of intra-ASEAN trade but also extra-ASEAN trade with all major trading partners of ASEAN, including the GATT and other economic communities such as APEC, the EU and the OECD.

Furthermore, the Fifth ASEAN Summit in Bangkok in 1995 emphasized and reconfirmed the former objectives of ASEAN in terms of the economic cooperation and integration. The Bangkok Declaration of 1995 accelerated progress towards the

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fields by their own way to fulfil the obligations of cooperation under this treaty in good faith. See Articles 1 and 3 of the treaty. Last but not least, Article 2 confirms the principle of non-intervention. This flexible legal regime of the ASEAN model of cooperation in turn marks a historic starting point of ASEAN economic integration.

realization of the AFTA before the target date of 2003 until when member countries intended to maximize the number of items with tariffs reduced to 0–5% by the year 2000; ASEAN members were to remove all quantitative restrictions and non-tariff barriers and were to schedule the elimination of non-tariff barriers beginning 1 January 1996; ASEAN envisaged harmonizing the tariff nomenclature at the HS eight-digit level and implementing the GATT Valuation System by 1997. ASEAN also created a green-lane system to expedite the clearance of CEPT products and expanded the number of products with tariffs reduced to 0% by the same year. With an expectation that ASEAN would change its legal nature from an association to an international organization in the near future, the text of the declaration used the word “ASEAN Members Countries” instead of “ASEAN Countries” or “ASEAN Nations”.

At that time, ASEAN became a de facto international organization because it had all kinds of ingredients to be an international organization, i.e. a secretariat, its own budget, personnel, archives and premises. Furthermore, ASEAN had already enlarged its membership to seven by admitting Brunei in January 1984 and Vietnam in 1995. Laos and Myanmar became ASEAN members in 1997 and Cambodia became a member in 1999, following the most important decision of ASEAN to change its legal status to the new ASEAN organization in which it has its own legal personality separately from that of its members by signing and ratifying the ASEAN Charter on 20 November 2007.

By adopting the “ASEAN vision 2020” at the Second Informal ASEAN Summit in Malaysia on 14–16 December 1997 and following the Declaration of ASEAN Concord II at Bali in 2003 at the Ninth ASEAN Summit or the so-called Bali Concord 2003, ASEAN will be, by 2020, an ASEAN Community, which will be composed of three pillars, namely the ASEAN Security Community (ASE), the AEC as the end goal of ASEAN economic integration and the ASEAN Socio-Cultural Community (ASCC). At that time, ASEAN will fully implement the AFTA and accelerate liberalization of trade in services and realize the ASEAN Investment Area (AIA) by 2010 and free flow of investments by 2020. However, this ambition does not mean that ASEAN will be transformed into an “ASEAN Union” similar to the EU.

Finally, at the 13th ASEAN Summit in Singapore in 2007 the Singapore Declaration of 2007 and the ASEAN Charter of 2007 reaffirmed the spirit of the Vientiane Action Programme adopted at the Tenth ASEAN Summit on 29–30 November 2004, the Kuala Lumpur Declaration on the Establishment of the ASEAN Charter of the Eleventh ASEAN Summit on 12–14 December 2005 and the Cebu Declaration on the Blueprint of the ASEAN Charter of the Twelfth ASEAN Summit on 9–15 January 2007.

Furthermore, ASEAN leaders signed the ASEAN Charter on 20 November 2007 and the ASEAN Charter serves as a legal and institutional framework, as well as inspiration for the ASEAN Community. By signing the Singapore Declaration of 2007 and the ASEAN Charter of 2007, the members must faithfully respect the rights and fulfil the obligations arising from the provisions of the ASEAN Charter and must complete ratification as soon as possible to bring the ASEAN Charter into

force. Furthermore, all members must undertake all appropriate measures in each member country to implement and comply with the provisions of the ASEAN Charter.

The ASEAN Charter entered into force on 15 December 2008. A gathering of the ASEAN foreign ministers was held at the ASEAN Secretariat in Jakarta to mark this very historic occasion for ASEAN.[3]

In accordance with the provision of Article 1.5 of the ASEAN Charter, the ASEAN Trade in Goods Agreement was signed at the 14th ASEAN Summit in Cha-Am Hua Hin Thailand, from 26 February to 1 March 2009. The target of ASEAN at present is to achieve the free flow of goods in ASEAN as the ASEAN single market and ASEAN member states will accelerate economic integration into the AEC by 2015 instead of 2020.

The Chairman's Statement of the 14th ASEAN Summit celebrated the entry into force of the ASEAN Charter on 15 December 2008. The ASEAN Charter provides the legal and institutional framework for ASEAN to be a rule-based organization similar to the WTO model. On 1 March 2009 at the 14th ASEAN Summit, ASEAN leaders also signed the Cha-Am Hua Hin Declaration on the Roadmap for the ASEAN Community (2009–2015), comprising the three pillars, namely, the ASEAN Political Security Community (APSC), the AEC and the ASCC.

The AFTA Council has agreed that the target dates to achieve zero tariff rates will be 2015 for the ASEAN-6 members (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand) and for the newer members there will be flexibility for some sensitive products of these countries. In this regard, an additional 7,881 tariff lines of ASEAN-6 will have zero tariffs by 2015, bringing the total number of tariff lines traded under the CEPTs for the AFTA to 54,457, or 99.11%.

Additionally, with the obligation of the reduction of tariffs, the average tariff rate for ASEAN-6 is expected to further decrease from 0.79% in 2009 to just 0.05% in 2010. In 2008 the intra-ASEAN import value of commodities for the aforementioned tariff lines amounted to US$ 22.66 billion, or 11.84% of the ASEAN-6 import value within ASEAN.[4]

ASEAN and Dialogue Partners

In conducting ASEAN's external relations, ASEAN has already made a lot of progress in terms of economic cooperation with its dialogue partners; many trade agreements were concluded between ASEAN and its dialogue partners and some tentative free trade agreements such as the ASEAN–US free trade agreement and

[3] http://www.asean.org/21861.htm, last accessed: 01.01.2010.

[4] http://www.asean.org/24146.htm, last accessed: 01.01.2010.

the bilateral free trade agreement between the USA and Thailand are awaiting their conclusion.

Nowadays, ASEAN has ten dialogue partners, namely Australia, Canada, China, the European Union, India, Japan, the Republic of Korea (ROK), New Zealand, Russia and the USA including UNDP.

Furthermore, ASEAN leaders recognized that existing ASEAN free trade agreements with dialogue partners are important for enhancing market access for ASEAN products and services in the rest of the world. In this regard, ASEAN leaders welcomed the progress of the implementation of the ASEAN–China Trade in Goods Agreement, the ASEAN–China Trade in Services Agreement, the ASEAN–ROK Trade in Goods Agreement and the ASEAN–Japan Comprehensive Economic Partnership Agreement. In the framework of ASEAN and dialogue partners, there has been a lot of progress in economic cooperation especially between ASEAN and Australia, China, Japan, Korea and the EU.

ASEAN–Australia–New Zealand

The agreement establishing the ASEAN–Australia–New Zealand Free Trade Area (ANNZFTA) was signed by the economic ministers of all parties at Cha-Am Hua Hin, Thailand, on 27 February 2009 and entered into force on 1 January 2010. The ratification processes in all 12 AANZFTA countries are on track to be completed soon.[5] The AANZFTA, once implemented, will substantially reduce barriers to trade in goods and services, opening up a wide range of opportunities for economic activities in the region. Tariffs on more than 90% of products traded between ASEAN, Australia and New Zealand will be eliminated either upon entry into force of the agreement or within the early stages of its implementation. The AANZFTA will also provide significant benefits in areas such as investment and economic cooperation. By 2010 more than 96% of Australian tariffs and more that 90% of New Zealand's tariffs on products from ASEAN will be eliminated by 2013; the remaining tariffs will be eliminated by 2020.[6]

ASEAN–China

The 15th ASEAN Summit in Cha-Am Hua Hin, Thailand, from 23–25 October 2009, emphasized the progress of the conclusion and implementation of the free

[5]From 1 January 2010, Brunei, Malaysia, Myanmar, Philippines, Singapore and Vietnam have been parties to the AANZFTA. The remaining ASEAN members (Cambodia, Indonesia, Laos and Thailand) are working to ratify AANZFTA at the earliest possible opportunity in 2010.

[6]A guide for ASEAN Business -ASEAN-AUSTRALIA-NEW ZEALAND Free Trade Area, ASEAN Secretariat, October 2009, p.5.

trade agreements with the trading partners, e.g. the completion of the ASEAN–China Free Trade Area (ACFTA) after the signing of the ASEAN–China Investment Agreement on 15 August 2009 in Bangkok and the signing of the Memorandum of Understanding (MOU) on the Establishment of the ASEAN–China Centre, including the signing of the MOU on cooperation in the field of intellectual property and an MOU on strengthening cooperation in the field of standards, technical regulations and conformity assessment. Much closer cooperation between China and ASEAN will soon develop, such as cooperation in the fields of transportation, health care and food security (including the formulation of a plan of action to implement the joint declaration on the China–ASEAN Strategic Partnership for Peace and Prosperity for 2011–2015).

The timeline for the conclusion of a Free Trade Agreement (FTA) in goods between ASEAN and China is 2010 for ASEAN-6, and 2015 for Cambodia, Laos, Myanmar and Vietnam. The agreements on trade in goods and a dispute settlement mechanism between ASEAN and China were signed in November 2004 in Vientiane; the agreement on trade in goods has been implemented since July 2005. In addition, the agreement on trade in services was signed at the Tenth ASEAN–China Summit, in January 2007 in Cebu, Philippines, and entered into force on 1 July 2007. Negotiations on the Comprehensive Investment Agreement have been completed and the agreement was signed on 26 February 2009 in Cha-Am, Thailand.[7]

The ACFTA has already been implemented completely since 1 January 2010. The ACFTA is the third largest free trade area and the trade between the parties was an impressive 13.3% of global trade in 2008. In addition, the ACFTA has a combined GDP of US$ 6.6 trillion, 1.9 billion people and total trade of US$ 4.3 trillion. The establishment of the full ACTFA also comes at a good time to boost regional recovery from the global economic crisis. China's phenomenal growth has positive effects on ASEAN's own expansion.[8]

ASEAN–Japan

Regarding the economic cooperation between ASEAN and Japan, ever since the Second ASEAN Summit in Kuala Lumpur in 1977, Japan has played an important role in the region's economic dynamism. The 1977 Asian financial crisis had a significant impact on the world and highlighted the interdependence of all nations, especially for the Asian economy. This phenomenon led to the establishment of ASEAN+3 (Japan, Korea and China). Japan created the Japan–ASEAN Solidarity Fund to assist the recovery of ASEAN countries from the economic crisis in 1999 and the Japan–ASEAN General Exchange Fund (JAGEF) in 2000.

[7] http://www.asean.org/22244.htm, last accessed: 08.01.2010.

[8] http://www.asean.org/24161.htm, last accessed: 08.01.2010.

In 2001, the ASEAN–Japan Eminent Persons Group developed a vision for Japan–ASEAN relations in the twenty-first century that proposed expanding their bilateral cooperation and expanding cooperation in many fields, such as food security, energy security, UN reform and WTO multilateral trade negotiations, including the building of an East Asia Economic Community (EAEC) in the long run.[9]

ASEAN and Japan completed the negotiation of the ASEAN–Japan Comprehensive Economic Partnership (AJCEP) in April 2008. The AJCEP agreement is comprehensive in scope, covering trade in goods, trade in services, investment and economic cooperation. The AJCEP will strengthen the economic ties between ASEAN and Japan and will create a larger and more efficient market with greater opportunities in this region. Laos, Myanmar, Singapore, Vietnam and Japan implemented the agreement on 1 December 2008, Brunei Darussalam implemented it on 1 January 2009 and Malaysia implemented it on 1 February 2009.[10]

ASEAN–Republic of Korea

Similarly, the cooperation between ASEAN and the Republic of Korea aims at political and security cooperation, economic cooperation, sociocultural cooperation, including the implementation of the Cha-am Hua Hin Declaration on the Roadmap for the ASEAN Community (2009–2015) and the Joint Statement of the ASEAN–ROK Commemorative Summit with the "New Asia Initiative", which will help to enhance regional integration and contribute to the ASEAN Community building process and ASEAN–Republic of Korea relations.

Furthermore, ASEAN and the Republic of Korea will join hands in pursuing the eventual goal of building an East Asian community as stated in the Kuala Lumpur Declaration on the ASEAN Plus Three Summit (2005) and the Second Joint Statement on East Asia Cooperation (2007). ASEAN and the Republic of Korea will position themselves as a bridge to link Northeast Asia and Southeast Asia together.[11]

Since the ASEAN–Korea Summit on 8 October 2003, considered as the starting point of ASEAN–Republic of Korea economic cooperation, the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and Korea was signed by the leaders at the ASEAN–Korea Summit on 13 December 2005 in Kuala Lumpur, Malaysia, and entered into force on 1 July 2006. The main elements of the framework agreement include:

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[9]Report of the ASEAN-JAPAN Eminent Persons Group: ASEAN Secretariat, October 2009, p. 3.

[10]http://www.asean.org/16580.htm, last accessed: 08.01.2010.

[11]Report of the ASEAN-Republic of Korea Eminent Persons Group: ASEAN Secretariat, September 2009, p. 14 items 11 and 12.

- The establishment of an ASEAN–Korea Free Trade Area (AKFTA).
- The implementation of AKFTA for trade in goods by 2012 for ASEAN-6, by 2018 for Vietnam and by 2020 for Cambodia, Laos and Myanmar as well as the implementation of the AKFTA for trade in services and investment, which will be realized within the time frames to be mutually agreed between ASEAN and the Republic of Korea.
- The cooperation in other fields such as custom procedures, trade and investment promotion, small and medium-sized enterprises, human resources management and development, tourism, science and technology, financial services, information and communication technology, agriculture, fisheries, livestock, plantation commodities and forestry, intellectual property, the environmental industry, broadcasting, construction technology, standard and conformity assessment and sanitary and phytosanitary measures, mining, energy, natural resources, shipbuilding, maritime transportation and the movie industry.

In the framework of the AKFTA, the Republic of Korea was to eliminate the tariffs on at least 70% of its products listed in the Normal Track on the date of the entry into force of the AKFTA (1 June 2007) and all tariffs of the Republic of Korea for products listed in the Normal Track were to be eliminated by 1 January 2010, whereas for ASEAN-6, tariffs were to be eliminated in four phases beginning from July 2006 and ending in 2012. However, Cambodia, Laos, Myanmar and Vietnam will enjoy special and differential treatment to extend the time frame for tariff cuts; Vietnam was given an additional 6 years whereas Cambodia, Laos and Myanmar were given an additional 8 years.[12]

ASEAN–EU

The ASEAN–EU dialogue relations were formalized at the Tenth ASEAN Foreign Ministers Meeting (AMM) in July 1977 and the ASEAN–EEC Cooperation Agreement was signed on 7 March 1980. The 17th ASEAN–EU Ministerial Meeting (AEMM) was held on 27–28 May 2009 in Phnom Penh and served as an action programme to deepen and intensify cooperation in every field between ASEAN and the EU for the period 2009–2010. At this meeting, the EU signed the Treaty of Amity and Cooperation in Southeast Asia and are expected to complete the accession process soon.

Furthermore, ASEAN–EU economic relations will be further intensified and strengthened with the launch of the ASEAN–EU FTA negotiations in May 2007. However, to allow for reflection on the appropriate format for the FTA negotiations, the Seventh Meeting of the Joint Committee for the ASEAN–EU FTA, which was held on 5–6 March 2009 in Kuala Lumpur, agreed to pause the negotiations.[13]

[12] http://www.matrade.gov.my/cms/content.jsp?id=com.tms.cms.article.Article_hide_ASEAN Korea, last accessed: 08.01.2010.

[13] http://www.asean.org/23216.htm, last accessed: 08.01.2010.

Legal Nature of ASEAN Economic Integration

At the beginning, ASEAN was an "association" of economic cooperation among the ASEAN countries, or the so-called ASEAN-5 founding nations. ASEAN was not an international organization or a regional organization as such owing to the lack of a constituent instrument. The Bangkok Declaration of 1968 is not the treaty establishing ASEAN as an international organization. The wording used in the preamble of the declaration is "Desiring to establish a firm foundation for common action to promote regional cooperation in South-East Asia in the spirit of equality and partnership and thereby contribute towards peace, progress and prosperity in the region" and did not seek to establish ASEAN as an international organization. The declaration emphasizes that the original signatory states of ASEAN declare, "First, the establishment of an Association for Regional Cooperation among the countries of South-East Asia to be known as the Association of South-East Asian Nations (ASEAN)". This statement shows clearly that the ASEAN founding nations had no intention to establish ASEAN as an international organization and ASEAN has no legal personality.

Although ASEAN was not an international organization de jure at the beginning, the development of ASEAN reflects that ASEAN had already all ingredients to be an international organization de facto because it has its own secretariat,[14] personnel, budget, archives and headquarters in Jakarta, Indonesia. This may be interpreted as ASEAN being an international organization de facto but not de jure.

The legal nature of ASEAN was changed in 1992 by the decision of the ASEAN countries during the Fourth ASEAN Summit in Singapore. This summit marks a historic development of ASEAN economic integration by its setting the AFTA as a legal mechanism for economic integration among ASEAN countries. However, the AFTA did not change ASEAN's legal nature. It took until 2007 at the 13th ASEAN Summit in Singapore for the ASEAN Charter to be signed and until 15 December 2008 for it to enter into force. ASEAN became an international organization de jure from then.

The ASEAN Charter serves as the constitution of the ASEAN members. It establishes ASEAN as an international organization and has its own legal personality[15]; the ten member states are Brunei Darussalam, the Kingdom of Cambodia, the Republic of Indonesia, the Lao People's Democratic Republic, Malaysia, the Union of Myanmar, the Republic of the Philippines, the Republic of Singapore, the Kingdom of Thailand and the Socialist Republic of Vietnam.[16] All members have rights and obligations under the ASEAN Charter provisions and must adapt their

[14]http://www.aseansec.org/22467.htm, last accessed: 09.01.2010. "The ASEAN Secretariat was set up in February 1976 by the Foreign Ministers of ASEAN. However, it was only in 1981 was the existing ASEAN Secretariat established. It was officiated in 1981 by the then-President of Indonesia, H.E. Soeharto".

[15]Article 3 ASEAN Charter.

[16]Article 4 ASEAN Charter.

domestic laws implement their obligations arising from the provisions of the ASEAN Charter.[17]

Furthermore, the ASEAN Charter serves as a firm foundation in achieving the ASEAN Community by providing a legal status and an institutional framework for ASEAN. It also codifies ASEAN norms, rules and values, sets clear targets for ASEAN, and presents accountability and compliance.

By 2015, the ASEAN Community will comprise three pillars, namely the ASEAN Political-Security Community, the AEC and the ASCC. Each pillar has its own blueprint, and, together with the Initiative for ASEAN Integration (IAI) Strategic Framework and IAI Work Plan Phase II (2009–2015), they form the Roadmap for the ASEAN Community 2009–2015.

In the framework of the AEC, the ASEAN vision 2020 was announced by the ASEAN leaders at the Second Informal ASEAN Summit in Malaysia, 14–16 December 1997. The ASEAN vision 2020 aims for ASEAN to be a zone of peace, freedom and neutrality, for the AFTA to be fully implemented, for liberalization of trade in services to be accelerated, and for the ASEAN Investment Area (AIA) to be realized by 2010. By 2020, ASEAN will transform its legal nature into the ASEAN Community.

It should be noted also that the AEC will transform ASEAN into a region with free movement of goods, services, investment, skilled labour, and capital. To fulfil this objective, the ASEAN leaders adopted the AEC blueprint at the 13th ASEAN Summit on 20 November 2007 in Singapore to serve as the master plan for guiding the establishment of the AEC by 2015. The AEC will establish ASEAN as a single market, a highly competitive economic region, a region of equitable economic development and a region fully integrated into the global economy.

Through AFTA, ASEAN will eliminate intra-ASEAN tariffs in accordance with the schedules and commitment set out in the CEPT-AFTA Agreement and other relevant agreements/protocols. However, free flow of goods would require not only zero tariffs but also the removal of non-tariff barriers. To implement the AEC more efficiently, the AEC blueprint refers, in addition, to trade facilitation measures such as integrating customs procedures, establishing the ASEAN Single Window,[18] continuously enhancing the CEPT Rules of Origin, including its operational certification procedures, and harmonizing standards and conformity procedures. Therefore, in establishing the AEC, ASEAN shall act in accordance with the principles of an open, outward-looking, inclusive and market-driven economy consistent with

[17]Article 5 ASEAN Charter.

[18]Section 18 AEC Blueprint reads: "ASEAN Single Window is an environment where ten National Single Windows of individual Member Countries operate and integrate. National Single Window enables a single submission of data and information, a single and synchronous processing of data and information and a single decision-making for customs clearance of cargo, which expedites the customs clearance, reduce transaction time and costs, and thus enhance trade efficiency and competitiveness".

multilateral rules as well as adherence to rules-based systems for effective compliance and implementation of economic commitments.[19]

Finally, ASEAN leaders agreed that the ASEAN Political-Security Community Blueprint, the ASEAN Economic Community Blueprint, the ASEAN Socio-Cultural Community Blueprint and the IAl Work Plan 2 (2009–2015) shall constitute the Roadmap for an ASEAN Community (2009–2015), and each ASEAN member state shall ensure its timely implementation. In this regard, the road map for the ASEAN Community (2009–2015) will be a guideline for the implementation of ASEAN vision 2020. Then, ASEAN will be a key regional organization for trade and investment liberalization and will support the four basic principles of the WTO, namely trade liberalization, non-discrimination, reciprocity and transparency.

Last but not least, ASEAN will be a complementary organization of the WTO and may facilitate and expand free trade in the globalized world. It should be noted also that the new legal model of ASEAN is not in contradiction with the WTO rules and principles. ASEAN integration has no negative impact and does not undermine the WTO principles or most-favoured-nation obligations of the WTO members because Article XXIV of GATT 1994 and Article V of GATS do allow the WTO members to establish free trade areas and customs unions as complementary means of trade liberalization. As the Doha Round is still in the stage of negotiation, ASEAN has already facilitated the free trade and investment growth in the region and may also facilitate economic expansion of the world economy. The full implementation of the ASEAN Community soon will demonstrate the efficiency of the long-term legal reform process of ASEAN from the old model as an "association" to the new model of the "ASEAN organization" or the so-called ASEAN Community.

[19]Section 5 AEC Blueprint.

Part III
International Economic Institutions

From the G8 to the G-20: Reforming the Global Economic Governance System

Claudia Schmucker and Katharina Gnath

Introduction: What a Difference a Year Can Make

The financial crisis has led to a critical juncture in economic and financial policy-making, triggering profound changes in the system of global governance – particularly to the architecture of the G-group summitry. Over the review period, formal and informal international coordination venues and fora proliferated. Yet the most far-reaching development in 2008 and 2009 was the establishment and permanent institutionalisation of the G-20 leaders' forum: the group that started as a ministers' round on financial stability roughly 10 years before has made a remarkable career over the past 12 months.

The chapter reviews the thematic and institutional developments in the context of the G summits from November 2008 until the end of 2009. It first traces the four summits at leaders' level before portraying possible scenarios for the future relationship of the G8 and the G-20. The last section provides an outlook and concludes the chapter.

Summit Hopping 2008 and 2009

Over the review period, the world saw a proliferation of G summits at leaders' level [1]: In November 2008, the G-20 gathered in Washington. In 2009, the G-20 met in

[1] Even more meetings took place at ministers' or official level. The chapter focuses, however, on the leaders' summits that structure the ongoing work of the international summit community and receive the highest public attention.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_18, © Springer-Verlag Berlin Heidelberg 2011

London in April and in Pittsburgh in September, and the G8 convened in L'Aquila, Italy, in July. At the Pittsburgh summit, the G-20 was institutionalised as the leading forum for international economic affairs.[2]

First G-20 Summit in Washington at Leaders' Level, November 2008

As the world was hit by a rapidly deepening financial crisis in the wake of the Lehman Brothers' bankruptcy in September 2008, then-US President George W. Bush called a "Summit on Financial Markets and the World Economy" in Washington, DC, on 15 and 16 November. The meeting, at which the representatives of the world's 20 leading countries and of relevant international organisations were present, was aimed at understanding the causes and cures for the crisis, at reaffirming the commitment to an open global economy and the fight against protectionism, and at rebuilding confidence in the global financial markets by demonstrating international political unitedness and cooperation.[3]

Discussions included inter alia better regulation of all financial service providers, markets and products (including hedge funds), an enhanced supervision of rating agencies, an increase in consumer protection in financial products, the curbing of tax havens, a reform of international financial institutions in favour of emerging countries' representation, and adjustments to managers' remuneration policies. Above all, the meeting was intended to identify broad principles for reforming the financial and regulatory system rather than to spell out concrete policy recommendations. The leaders developed an action plan with 47 short- and medium-term action points to be elaborated and implemented subsequently.

The meeting can be considered historical not for the results achieved, but for the change in international governance structures that it heralded: instead of an additional G8 meeting being convened in autumn 2008, it was decided that the old forum was not the appropriate venue to discuss the causes of and solutions for the

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[2]The original finance ministers' G-20 consists of Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the UK and the US. The 20th member is the EU, which is represented by the rotating Council presidency and the European Central Bank. In addition, the International Monetary Fund (IMF), the World Bank and the chairs of the International Monetary and Financial Committee (IMF) and the Development Committee (World Bank) also participate. Several other countries took part in the G-20 leaders' summits of 2008 and 2009: The Czech Republic and Sweden (as European Presidency representatives in Washington 2008 and London 2009, and Pittsburg 2009, respectively); Spain (all three summits); the Netherlands (all three summits), Ethiopia and Thailand (as representatives of NEPAD and ASEAN in London 2009). However, given the group's informality and recency, membership is not fixed and can be changed by the individual presidency.

[3]Declaration, Summit on Financial Markets and the World Economy, 15 November 2008, http://www.g20.org/Documents/g20_summit_declaration.pdf, last accessed 13.11.2009.

global financial crisis. The Washington summit lifted the G-20 – a group that until then had only existed at the level of finance ministers and central bankers – to the leaders' level, laying the institutional foundation for a revised membership structure of the summits in the following months.

Second G-20 Summit in London, April 2009

On 2 April 2009, the heads of state of the G-20 met in London for the second time to continue coordinating their crisis management and to "restore confidence, growth, and jobs".[4] As a measure to dampen the repercussions of the financial crisis, G-20 countries pledged 1.1 trillion USD for the IMF and other multilateral organisations, consisting of 750 billion USD of direct aid and 250 billion USD in special drawing rights for the IMF, as well as 100 billion USD for multilateral development banks to increase lending.

Furthermore, then UK Prime Minister Gordon Brown announced in his role as G-20 President the establishment of a "new world economic order": most importantly, the G-20 leaders agreed to create a Financial Stability Board (FSB), replacing and expanding the former Financial Stability Forum.[5] Together with the IMF, the newly established FSB was designed as part of an early-warning system to identify and address international macroeconomic and financial risks. With regard to global financial regulatory reform, the G-20 agreed inter alia on the following measures in form of the "Declaration on Strengthening the Financial System"[6]: an increase of capital buffers in good times and the enhancement of the quality of capital, a gradual adoption of the Basel II framework for all G-20 countries – including the USA, the registration of hedge fund managers, the standardisation of the credit derivates markets and the development of global accounting standards. In addition, the G-20 decided that compensation practices had to be consistent with the long-term goals of banks and companies and should support prudent risk-taking.

A further key issue at the London summit was the abolishment of tax havens. On the basis of the previously published OECD list of non-cooperative jurisdictions (black and grey list),[7] the targeted countries increased their commitment to

[4]G-20, The Global Plan for Recovery and Reform, London, 2 April 2009, http://www.g20.utoronto.ca/2009/2009communique0402.pdf, last accessed 28.10.2009.

[5]The new FSB includes all G-20 members, Spain, Hong Kong, the Netherlands, Switzerland, as well as representatives from the BIS, OECD, European Central Bank and the European Commission, the IMF, the World Bank and some further standard-setting bodies. See FSB, Members, http://www.financialstabilityboard.org/members/links.htm, last accessed 11.11.2009.

[6]G-20, Declaration on Strengthening the Financial System – London Summit, 2 April 2009, http://www.g20.utoronto.ca/2009/2009ifi.pdf, last accessed 24.11.2009.

[7]OECD, A Progress Report on the Jurisdiction Surveyed By the OECD Global Forum in Implementing the Internationally Agreed Tax Standard, Original Report of 2 April 2009, http://www.oecd.org/dataoecd/38/14/42497950.pdf, last accessed 11.11.2009.

implement international standards for the exchange of tax information. The G-20 pushed for greater action against countries that continued to be unwilling to cooperate and promised in the final document "The era of banking secrecy is over".

G8 Summit in L'Aquila, July 2009

The topic that received most attention at the G8 leaders' summit in L'Aquila, which took place from 8 to 10 July 2009, was climate change. Further discussions centred on security issues, development policy – especially with a view to Africa – and trade. The summit took place in the face of the ongoing global financial and economic crisis. Yet, although many references were made to the economic situation of the previous months, hardly any concrete steps or decisions were taken in this area. In fact, Especially the US administration conceived the 2009 G8 summit more as an intermediate step rather than the main venue to discuss questions of world economic and financial order.[8]

Climate Change

Similar to past years' summits, the G8 leaders' meeting in 2009 was dominated by the debate over global warming. In the run-up to the UN Climate Change Conference (COP15) in Copenhagen at the end of 2009, the L'Aquila summit intended to send a signal of the industrialised states' willingness to come to an agreement and to encourage emerging countries to offer further emission reductions themselves. For the first time, the leaders of both the G8 and big emerging countries agreed within the framework of the Major Economies Forum (MEF),[9] which took place on the second day of the summit, that global warming must be restricted to 2°C. To achieve this goal, the industrialised states committed to reducing their emissions by 80% or more by 2050. However, no target was formulated for the period until 2020, the reference time horizon of the UN discussions. Furthermore, no concrete steps were taken to finance the necessary emission reductions and climate mitigation schemes.

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[8]See, e.g., the comment by Mike Froman, US G8-sherpa, cited in Baker/Donadio, Group of 8 is Not Enough, Say Outsiders Wanting In, New York Times, 10 July 2009, p. 13; see also Andrews, Group of 20 nations will replace elite G-7, The International Herald Tribune, 26 September 2009, p. 4.

[9]The 17 major economies participating in the MEF are those of Australia, Brazil, Canada, China, the EU, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, South Africa, the UK and the USA. Denmark, in its capacity as President of the December 2009 Conference of the Parties to the UN Framework Convention on Climate Change, and the UN were also invited to participate in the discussions. See US Department of State, Major Economies Forum on Energy and Climate, http://www.state.gov/r/pa/prs/ps/2009/04/122097.htm, last accessed 13.11.2009.

Africa

Another recurring topic of G8 summits is development aid, particularly for Africa. To counter the heightened risk following the volatile food prices of the months prior to the L'Aquila summit, the leaders agreed that local food markets should be made more profitable and competitive instead of continuing with the policy of direct food aid. To this end, the G8 committed to provide 20 billion USD in aid over the coming 3 years and established a special fund for local agricultural development (L'Aquila Food Security Initiative).[10] Furthermore, the G8 reaffirmed their previous development commitments – despite Italy and other members having come under heavy criticism for cutting their promised G8 aid payments substantially.

Security Policy

Leaders "deplored" postelectoral violence in Iran and committed to closely observe further developments especially with regard to Iran's nuclear programme.[11] In contrast to previous discussions, Russia's President Dmitri Medvedev agreed to toughen the tone on Iran together with the other G8 members. Further security-related discussions at L'Aquila included the fight against piracy, North Korea and non-proliferation, the Middle East and the war in Afghanistan. US President Barack Obama used the L'Aquila gathering to announce his intention to convene a nuclear security summit in early 2010 in Washington.

Trade and the Doha Round

As a reaction to the economic downturn following the recent financial crisis, global free trade has come under pressure. To curb protectionist developments, the leaders reiterated their commitment in L'Aquila to reopen the flagging multilateral trade negotiations at the WTO and to finish the Doha Round in 2010.

The Heiligendamm–L'Aquila Process and Variable Summit Geometry

It was decided at the 2007 Heiligendamm summit to establish a structured outreach dialogue with five big emerging countries ("O5": Brazil, China, India, Mexico, and South Africa). The "Heiligendamm Process" was established for an initial period of 2 years. A final report of the first phase was issued at L'Aquila, and it was decided

[10]Under the aegis of the USA and Japan, financing means will be provided to increase the quality of cropping methods and to deepen local markets. This initiative marks a shift especially for US development policy, which focused previously on direct food support.

[11]G8, Political Issues, 8 July 2009, http://www.g8.utoronto.ca/summit/2009laquila/2009-political.pdf, last accessed 21.10.2009.

to continue the process – now coined Heiligendamm–L'Aquila Process (HAP) – for at least another 2 years, albeit in a more flexible format than before.[12]

However, the HAP was not the only outreach format at the G8 leaders' summit in L'Aquila. In fact, the summit stands out for its very flexibility in terms of country groupings: leaders from around 40 countries and international organisations met in seven different constellations over the course of the 3 days, leading to a proliferation of documents and statements being adopted in L'Aquila.[13] Although the G8 met on its own on the first day, discussions took place in a range of different formats from the second day onwards, depending on the subject under discussion. This included inter alia meetings among the G8 with the O5 and Egypt, with international organisations and with African leaders.[14] Furthermore, US President Barack Obama convened a MEF meeting of around 20 countries to discuss global warming on top of the G8 talks.[15] As a consequence, the Italian presidency effectively transformed the G8 into a network of overlapping circles of countries, and it is unlikely that it will return to a closed-door summit format in the future.

Third G-20 Summit in Pittsburgh, September 2009

The London G-20 summit had mainly dealt with economic recovery from the financial crisis. The Pittsburgh summit, which took place on 24 and 25 September 2009 against the background of a gradually improving global economic outlook, focused instead more on financial regulatory reform and macroeconomic imbalances. Further important topics included the reform of compensation practices (bonuses) and IMF reform.

Global Imbalances

At the Pittsburgh summit, the USA in particular pushed for greater international cooperation to counter global macroeconomic imbalances: over the past few years, countries such as the USA had accumulated a large budget and current account deficit, whereas countries such as China, Japan and Germany had experienced export surpluses. The resulting sizeable capital flows posed a destabilising risk to the global economy. President Obama therefore asked the leading export countries

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[12]G8, The Agenda of the Heiligendamm-L'Aquila Process, 9 July 2009, http://www.g8italia2009.it/static/G8_Allegato/06_Annex_2__Concept_Note_on_HAP.pdf, last accessed 5.10.2009.

[13]See G8 Chair's Summary, 10 July 2009, http://www.g8.utoronto.ca/summit/2009laquila/2009-summary.pdf, last accessed 22.10.2009.

[14]See, e.g., Ehrlich, Experimente auf dem Gipfel, Financial Times Deutschland, 10 July 2009, p. 27; Baker/Donadio, Group of 8 is Not Enough, Say Outsiders Wanting in, New York Times 10 July 2009, p. 13.

[15]Lee, Financial Crisis, Los Angeles Times, 8 July 2009, p. 1.

in Pittsburgh to increase domestic demand to fill the gap left by US consumers. In addition, the USA committed itself to increase its savings rate, and to reduce its trade and budget deficit.

In this context, a new "Framework for Strong, Sustainable and Balanced Growth" was initiated. From now on, G-20 members will meet periodically to review each others' national economic policies. The IMF was mandated to supervise the framework: it will prepare technical analyses on the consistency of the individual G-20 members' economic policies and their support of a more sustainable and balanced growth for the global economy. Enforcement mechanisms, such as penalties or sanctions, were left out of the agreement. This was a necessary precondition to gain the consent of large emerging countries such as China, India and Brazil and of industrialised countries (Germany and Japan). The main coordinating instrument is now a process of mutual assessment and peer pressure – naturally a much weaker force to adjust.

At their meeting in St. Andrews (UK) in November 2009, the G-20 finance ministers added a time frame to the agreement: they decided to prepare and present national policy frameworks until the end of January 2010, to conclude the first mutual assessment by April 2010, to prepare policy options for the next summit meeting in June 2010 in Canada and to establish concrete policy recommendations for the G-20 summit in Korea in November 2010.

Financial Regulation

On international financial regulation, the G-20 agreed on a broad reform agenda, which included increased capital requirements for banks, the establishment of leverage or liquidity ratios, better insolvency proceedings for large banks and a standardisation of accounting practices. Definite time frames were approved. Furthermore, the leaders came to the agreement that inadequate and procyclical banking regulation was the main cause of the outbreak of the financial crisis.

The USA, in particular, promoted the issue of better capital requirements for banks: the leaders finally agreed to establish international rules by the end of 2010 to improve the quantity and quality of capital. These rules should be implemented by the end of 2012 – when it is believed that the current crisis will have been overcome. The aim of the decision was to force banks to raise capital in good times as buffers against potential losses in bad times. In addition, the G-20 agreed on higher capital standards for banks that are very large and are systematically interlinked with other finance institutions and, therefore, pose a greater threat to the system if they fail. The rules were based on proposals launched by the Basel committee of banking regulators at the beginning of September 2009. All major financial centres were also asked to adopt the Basel II capital standards by 2011.

The G-20 further agreed to introduce leverage and liquidity ratios for banks. However, this issue was rather sensitive because of large differences in European and US accounting standards. The G-20 therefore called on the International Accounting Standards Board (IASB) to complete accounting convergence by

June 2011 to prevent possible disadvantages for banks regarding the amount of capital needed.

Compensation Practices

Compensation practices were subject to a heated debate between the G-20 member states in the run-up to and during the summit. Countries such as Germany and France had been adamant ahead of the Pittsburgh summit that strict rules and restrictions on bonuses were a necessary requirement for the summit's success. However, owing to heavy opposition from the USA and the UK, the G-20 did not agree on a direct cap on bonus payments for managers.

Nevertheless, tough guidelines regarding bonuses were established in Pittsburgh – to be implemented no later than March 2010: the G-20 leaders decided that bonuses would have to be paid in shares rather than cash in the future, between a half and two thirds of the bonuses would be deferred for 3 years so that they could be withheld in case of unsatisfactory performance, and bonuses had to be based on the performance of a bank. In case of a breach, national supervisors were allowed to impose sanctions such as higher capital requirements for individual banks in the future.

IMF Reform

In the opinion of large emerging countries such as China, India and Brazil, one of the most important issues of the summit was the reform of the IMF. Although some of the big emerging countries were also heavily affected by the aftermath of the financial crisis and the subsequent global economic downturn, they were less preoccupied with the immediate disruptions in the financial markets and the burden on public budgets. Their main focus at the summit lay on their stronger integration into and representation in international financial institutions instead. After drawn-out discussions in other fora, the G-20 finally agreed on a transfer of 5% of voting shares from the industrialised countries to the emerging economies at the IMF. Although the deal did not match the emerging countries' demand for a 7% increase to fully even out the voting power asymmetry between industrialised and emerging countries, it showed that the G-20 could agree on concrete figures and the deal can, therefore, be seen as a first step in the right direction. Detailed negotiations on this issue were scheduled to be held at the IMF in the months following the summit and are due to be concluded by January 2011.

The USA has been pursuing plans to reduce the number of IMF board seats from 24 to 20. However, one third of the executive director positions are held by European countries and they would be bound to lose some in the case of a reshuffle. Therefore, any debate on IMF governance reform was prevented by European countries at the Pittsburgh summit – particularly by the French and British governments, who were afraid of losing relative influence at the IMF.

Exit Strategies

Since the outbreak of the financial crisis, countries have, altogether, pledged five trillion USD in fiscal stimulus to restore recovery. At the G-20 summit in Pittsburgh, especially Germany emphasised the need for a coordinated exit strategy from stimulus programmes. However, Chancellor Angela Merkel received heavy opposition from the USA and the UK: as a result, the G-20 agreed in their communiqué that it was "premature" to start withdrawing from public spending programmes. Furthermore, the G-20 came to the common conclusion that "the scale, timing, and sequencing of actions will vary across countries or regions and across the type of policy measures".[16]

Climate Change and the Doha Round

Originally, the newly institutionalised G-20 made it its business to focus on global financial issues; the summit in Pittsburgh added climate change and trade to the agenda, which had so far been discussed at the level of the G8 only. However, the outcome on climate change fell far short of the hopes of the G-20 and outsiders. Especially China and India were adamantly opposed to discussing global warming in this forum; in their view, the UN or the MEF is a more appropriate venue for this matter. The USA was also unable to make concessions on climate change, as the US Senate had deferred the cap-and-trade bill to the following year.

Another aim of the Pittsburgh summit was the support of the successful conclusion of the Doha Round. However, similar to the language agreed in L'Aquila, the G-20 leaders only reiterated that the Doha Round should be concluded in 2010 and that the necessary steps should be taken to accomplish this goal.

A Permanent Upgrade of the G-20

One of the most far-reaching decisions taken at the Pittsburgh summit was the G-20's upgrading to a permanent leaders' forum with an annually rotating chairmanship. The preamble of the Pittsburgh communiqué established: "We designated the G-20 to be the premier forum for our international economic cooperation".[17] The G-20 has thus come a long way from its origins, founded in 1999 after the Asian financial crisis to bring together finance ministers and heads of central banks. At the first meeting in Washington, upgrading the G-20 had a mainly symbolic function. Over the course of the three summits, it became an official policy stance:

[16] G-20, Leaders Statement: The Pittsburgh Summit, 25 September 2009, http://www.g20.utoronto.ca/2009/2009communique0925.html, last accessed 28.9.2009.

[17] G-20, Leaders Statement: The Pittsburgh Summit, Pittsburgh, 25 September 2009 http://www.g20.utoronto.ca/2009/2009communique0925.html, last accessed 28.9.2009.

the G-20 has transformed itself into the leading economic forum where heads of state meet to deal with problems of the world economy. The next meeting will take place alongside the G8 summit in Canada in June 2010. The official 2010 G-20 summit will take place in November 2010 in South Korea, which holds the 2010 G-20 presidency.

Assessment: The G8 and G-20 – Competing, Coexisting or Cooperating?[18]

With the permanent establishment of the G-20 leaders' summit in September 2009, a clear shift in governance structure has taken place within the system of informal, plurilateral G summit meetings. The following section analyses three different scenarios of how the future relationship between the G8 and the G-20 may develop. The three options – competition, coexistence and cooperation – depict analytical ideal types and can exist in a mix, containing elements of some or all variants.

Competition: (Unfriendly) Takeover of the G8 by the G-20

In the first scenario, the G8 and the G-20 will compete with each other on issues, overall relevance and legitimacy. It is very unlikely that the G8 would regain the position of the leading forum. Therefore, under competition, the G8 will effectively cease to play an important role – even if it manages to remain in existence in the formal sense – or disappear as a format altogether. The G-20 will then widen its agenda beyond its present focus on economic issues and emerge as the "summit of summits".[19]

Large emerging countries such as India, Brazil and China, which are not part of the G8, but are equal members of the G-20, have stressed that the G8 has lost its effectiveness and legitimacy to the G-20 and should be abandoned as a format. The Brazilian Foreign Minister, Celso Amorim, declared that "the G8 is over as a political decision group".[20] And the Indian Finance Minister, referring to the G7

[18]Quoting John Kirton in Qiao, From G8 to G-20, coexistence, cooperation, competition are rules to play, Canadian experts say, China View, 7 October 2009, http://www.cigionline.org/articles/2009/10/g8-g20-coexistence-cooperation-competition-are-rules-play-canadian-experts-say, last accessed 11.11.2009.

[19]Cooper, Competing Gs?: G-20, G8 and Crisis Management, Paper Prepared for the 2009 Pre-G8 Summit Conference on "Global Financial Crises: national Economic Solutions, Geopolitical Impacts", 30 June 2009, pp.7–8, http://www.g8.utoronto.ca/conferences/2009/unicredit-cooper.pdf, last accessed 13.11.2009.

[20]Celso Amorim quoted in Baker/Donadio, Group of 8 is Not Enough, Say Outsiders Wanting In, New York Times, 10 July 2009, p. 13.

as the G8's subgroup concerned with financial issues, stated: "The G7 has recognized belatedly that they alone don't have the solutions to all the problems. The G-20 has come to stay as the single most important forum to address the financial and economic issues of the world. The G-20 is a much better forum than the G7".[21] Even Peter Mandelson, then trade minister of the one of the core-G8 countries – the UK – stated before the London summit in March 2009 that the "era of the G8 is over".[22]

At first sight, this scenario seems the most appropriate to characterise the relationship of the G8 and the G-20 over the review period and the best guiding principle of the G group's future relationship. For example, the US administration commented: "Dramatic changes in the world economy have not always been reflected in the global architecture for economic cooperation. This all started to change today. The G-20 leaders reached a historic agreement to put the G-20 at the centre of their efforts to work together to build a durable recovery while avoiding the financial fragilities that led to the crisis".[23] The G-20 has already taken over one of the most important points of the G8 agenda – international economic cooperation. As such, the G-20 agreed on new financial regulations and proved to be a catalyst for the reform of other international financial institutions, such as the FSB and the IMF. And although the G8 summit in L'Aquila showed a high degree of flexibility regarding the format, the G8 has clearly lost legitimacy and public attention in relation to the G-20, the members of which together represent around 90% of global GDP, 80% of world trade and two thirds of the world's population.[24]

Coexistence: A Division of Labour Between the G8 and the G-20

A possible alternative is a coexistence between the two groups, each with its distinct group dynamic, agenda and timetable – and a clear division of preparatory work and topics discussed. Under this scenario, summits will remain distinctive, and the different presidencies will ensure that the two formats coexist at least in the medium term. Accordingly, topics and functions will be divided according to the membership structure and capabilities of the groups. For example, it is conceivable that although the G7 of finance ministers that form a subgroup of the G8 at ministers'

[21] Mathuros, G-20 replaces G7 as the most important global forum on economic issues, says Indian finance chief, World Economic Forum, 18 November 2008, http://www.weforum.org/en/media/Latest%20Press%20Releases/PR_IES08_G-20G7, last accessed 17.11.2009.

[22] British trade minister: Era of G8 is over, http://www.topnews.in/british-trade-minister-era-g8-over-2144363, last accessed 17/11/2009.

[23] Statement by the US White House, The Pittsburgh Summit: Creating a 21st Century International Economic architecture, http://www.whitehouse.gov/files/documents/g20/Architecture_Fact_Sheet.pdf, last accessed 24.11.2009.

[24] See, e.g., German Federal Finance Ministry, Glossary, http://www.bundesfinanzministerium.de/nn_39824/DE/BMF__Startseite/Service/Glossar/G/011__G-20.html, last accessed 23.11.2009.

level will be permanently replaced by the G-20 as a global forum for economic policies, the G8 could nevertheless meaningfully deal with non-economic issues, such as development, energy and security policy.

A first analysis of the summits in 2009 suggests that some division of labour in terms of topics has indeed taken place: the G8 summit focused mainly on non-economic issues such as climate change, as well as on development and security issues, including non-proliferation and Afghanistan. Other (non-economic) topics included health, food security and energy.[25] The "traditional" G8 issue of international economic policy was mostly sidelined at the G8 summit in L'Aquila – despite constant reference to the current economic crisis and the need to enhance global economic governance. Substantive discussion on these issues was shifted to the G-20 and the summit in Pittsburgh: The G-20 leaders' meetings dealt mainly with financial stability, macroeconomic imbalances and policies, financial regulation and supervision.

At least in 2010, elements of coexistence were present given the different presidencies of the G8 (Canada) and the G-20 (South Korea), which both held their own summits and drove forward their agendas. Canada's Prime Minister Stephen Harper ensured that the two summits remained distinctive: "We are not replacing the G8".[26]

Cooperation: The G8 as a Caucus Group of the G-20

A third option highlights the possibility of the two groups' complementarity: the G8 and G-20 will closely interact on all topics of global relevance, fora will overlap with each other in terms of topics and preparatory personnel involved, and the G8 and G-20 will coordinate their agendas and timetables – and possibly even synchronise their presidencies. Under this scenario, the groups do not necessarily have to be on par with each other: it is likely that the smaller forum will take the role of a caucus group within the broader framework of the G-20. Thus, in a sense, the G8 will become more like a dinner club rather than the foremost agenda-setter and (rival) decision-making body, serving as a preparatory group of like-minded countries nested within the G-20 that sits at the apex of the G summit community.[27]

Apart from US President Obama, Germany's Chancellor Angela Merkel is supportive of this model. This is all the more telling as she was the driving force

[25]See e.g., Grice, Brown claims victory after G-20 agrees to curb bonuses, The Independent, 26 September 2009, p. 6; see also Andrews, Group of 20 nations will replace elite G-7, International Herald Tribune, 26 September 2009, p. 4.

[26]Quoted in CBC News, Broad Consensus as G-20 supplants G8, http://www.cbc.ca/world/story/2009/09/25/g20-pittsburgh-economy314.html, last accessed 24.11.2009.

[27]See Baker, Deliberative International Financial Governance and Apex Policy Forums: Where we are and where we should be headed, in: Underhill/Blom/Mügge, *Financial Integration Thirty Years On*, forthcoming.

behind establishing the Heiligendamm Process to prevent the G8 from formally enlarging in 2007. According to Merkel, the G8 summit is not sufficient any more and should be rather used as a venue for preliminary discussions.[28] Her recent shift in opinion stands for a larger change of view among the original G8 members.

Elements of such thematic overlap of the two groupings and a two-tiered system could be observed in the review period. For example, the issue of climate change that was discussed both in L'Aquila and in Pittsburgh – in preparation for the COP15 meeting. Similarly, trade policy and the successful conclusion of the Doha Round were put on both the G8 agenda and the G-20 agenda.[29] Furthermore, although the G8 summits in July 2009 touched on the traditional core G8 topics of international economic policy, the issues were mainly referred to the Pittsburgh gathering 2 months later. Thus, the L'Aquila summit can be conceived as a preparatory midpoint between the G-20 summits in London and Pittsburgh.

Outlook for the G8 and the G-20: Of Chances and Challenges

It is too early to tell which option will dominate the relations between the G8 and the G-20 over the coming months and years, and the previous assessments of the first 12 months of the G-20 only depict a first (speculative) outlook of what may come. Given the dramatic developments in international economic governance of the past few months, one is quick to point to the first option – competition – as the most appropriate framework both to assess the governance changes of the past few months and to guide the future potential path of the G groups. Yet, a closer look shows that elements of the second and third scenarios – coexistence and cooperation – have also been observable over the review period and are likely to continue to characterise the relationship between the G8 and the G-20 – at least in the medium term.

Thus, the most probable scenario is that the G8 will not be abolished, but that it will become a more informal coordinating meeting ahead of the G-20, where the leaders of the large industrialised countries will meet. The G8 will most likely focus more on foreign and security issues, whereas the main financial and economic questions will be discussed within the G-20. However, issues such as climate change and trade will be on the agenda of both groups. As such, the G8 will be both a small G group focusing more and more on foreign and security issues as well as a preparatory body for issues of global concern.

Such assessment of the G8's relative survival – albeit in a different shape than in the past – should not belittle the stellar rise of the G-20 over the review period: the

[28]Merkel, Government declaration of Chancellor Merkel at the G8 summit in July, 2 July 2009, http://www.bundesregierung.de/nn_1502/Content/DE/Regierungserklaerung/2009/2009-07-02-merkel-regerkl-g8.html, last accessed 23.10.2009; US President Obama quoted in Andrews, Group of 20 nations will replace elite G-7, International Herald Tribune, 26 September 2009, p. 4.

[29]In fact, those topics were only prediscussed at the G summits, as they are ultimately negotiated and decided at the UN and the WTO.

three successful G-20 meetings at the highest political level in 2008 and 2009 have elevated the newly upgraded group to a leading international agenda-setting body in record speed, supplanting to some extent the smaller G8 that has been dominated by Western industrialised countries. Although the creation of the G-20 at leaders' level was partly accidental and owed much to the political momentum of the financial crisis, the change is nevertheless indicative of a more long-term underlying consensus within the international community that economic global governance has been in dire need of change for some time. The newly institutionalised G-20 leaders' summits are thus a reflection of the changing international economic realities in the twenty-first century: it was long overdue that large emerging countries such as China, India and Brazil should receive a seat at the table when global problems such as the world economy, climate change and trade are discussed.

However, in the long run, the legitimacy of the G-20 will crucially depend on its success, and the newly founded forum is not without problems: even though the group is more representative than the G8, the EU is still overrepresented, whereas African countries are largely not present (South Africa is an exception, but is often not considered as being a representative African country). In addition, the new G-20 lacks the intimacy of the G8, and membership is more heterogeneous. Thus, the greater number of players with more diverse interests and political priorities will make negotiations more drawn out and agreement more difficult. It could already be observed that different conceptions of the crisis and its solution exist among by the main players (EU, USA, China).[30] Moreover, the agenda so far has been dominated by the EU and the USA (financial regulation),[31] whereas topics such as trade protection and IMF reform, which are of interest to the large emerging countries, have had a lower priority. In the future, these different interests and priorities will have to be adjusted mutually – a process which can be painful and slow.

The future G-20 presidencies - starting in 2010 with South Korea – a newly industrialised country, have to show leadership and political acumen in navigating the G8 and the G-20 through the rough waters of governance transition.

[30]See, e.g., Pettis, The G-20 Meetings: No Common Framework, No Consensus, Carnegie Endowment for International Peace Policy Brief 79, May 2009, p. 3, http://www.carnegieendowment.org/files/g20_consensus.pdf, last accessed 13.11.2009.

[31]See, e.g., Pisani-Ferry/Bénassy-Quéré/Kumar, The G-20 is not just a G7 with extra chairs, Bruegel Policy Contribution 2009/10, September 2009, http://www.bruegel.org/nc/publications/show/publication/the-g20-is-not-just-a-g7-with-extra-chairs.html, last accessed 19.11.2009.

The Doha Development Agenda at a Crossroads: What Are the Remaining Obstacles to the Conclusion of the Round: Part II?

Edwini Kessie

Introduction

Following the circulation of the revised draft modalities texts in agriculture and NAMA in December 2008, there was some optimism that the modalities could probably be agreed in the course of 2009, setting up the stage for the conclusion of the Doha Round by the end of 2010. While some progress had been made in addressing some of the outstanding issues in the various negotiating areas in the course of 2008, work on the Doha Round was overshadowed by the global financial crisis, which saw many WTO Members adopt a plethora of measures, including providing subsidies to loss-making manufacturing and service companies, raising applied tariffs to their bound levels, imposing anti-dumping and countervailing duties to protect their companies and jobs. In his statement to the Trade Negotiations Committee in December 2008, Director-General Lamy acknowledged that 2008 had been a difficult year, but exhorted WTO Members to work hard and bridge the gaps in their negotiating positions in 2009.[1]

With the financial crisis escalating in the beginning of 2009, two main schools of thought emerged on the future of the Doha Round. There were those who believed that the crisis offered an opportunity to make substantive progress in the negotiations given the fact that countries would not like to jeopardize the fragile global economic recovery and would like to see it strengthened to provide a further boost to the global economy and also to restrain countries from adopting protectionist measures which would undermine the effectiveness of the multilateral trading system. The other school of thought expressed the view that the crisis would

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[1]See statement by Pascal Lamy to the Trade Negotiations Committee on 24 July 2009, http://www.wto.org/english/news_e/news09_e/tnc_dg_stat_24jul09_e.htm.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_19, © Springer-Verlag Berlin Heidelberg 2011

undermine support for further liberalization and encourage countries to adopt measures, which may not necessarily be WTO consistent, to pull their economies out of recession.

In a way, both schools of thought were partially right in their predictions. The fact that the modalities have not yet been adopted is evidence of countries having other priorities, including probably strengthening their economies before fully engaging in the Doha negotiations. The irony is that concluding the Doha Round could be a part of the solution in terms of promoting domestic economic recovery and strengthening the global economic recovery. On the other hand, the fact that some countries adopted further liberalizing measures beyond their WTO commitments to promote trade and investment is an indication of their willingness to fully engage in the Doha negotiations and make the necessary compromises to bring them to a closure.[2]

As the year progressed, there was still some optimism that the modalities could be adopted and the Round concluded by the end of December. There were a number of communications issued by global and regional bodies, including the African Union, ASEAN, the CAIRNS Group, G-20 pledging their commitment to the Doha Round and calling for its conclusion as soon as possible. In his statement to the Trade Negotiations Committee, Director-General Lamy noted that in his contacts with Ministers and world leaders, there was a "genuine and strong renewal of political commitment to re-engage in the Doha negotiations and to conclude it in 2010. There were expressions of the need to fill in remaining gaps as soon as possible and of the desire to enhance transparency and understanding of what is on the table".[3] At a mini-Ministerial meeting in New Delhi on 3–4 September 2009, there was some optimism that the Ministers would produce a blueprint for the conclusion of the Round in 2010.[4] While some modest progress was made, the meeting failed to narrow the major differences in Members' views on the key outstanding issues in agriculture, NAMA and other negotiating areas. Given that it had already been decided that the Ministerial meeting on 29 November to 2 December would be a regular meeting to consider a number of issues affecting the operation of the multilateral trading system, it was not expected that Ministers would address the outstanding issues in agriculture, NAMA and in the other negotiating areas or come up with a detailed blueprint to guide the negotiations to a conclusion.

At the meeting, Ministers reaffirmed their commitment to concluding the Round in 2010. To that end, they directed senior officials "to work to map the road towards that point" and asked that that a stock-taking exercise take place in the first-quarter

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[2]See Report to the TPRB from the Director-General on Trade-Related Developments, WT/TPR/OV/W/3; 14 June 2010, para.7 at p2.

[3]See statement by Pascal Lamy to the Trade Negotiations Committee on 24 July 2009, http://www.wto.org/english/news_e/news09_e/tnc_dg_stat_24jul09_e.htm.

[4]See Speech by Director-General Lamy to the Federation of the Chambers of Commerce and Industry in New Delhi, India on 3 September 2009, http://www.wto.org/english/news_e/sppl_e/sppl133_e.htm.

of 2010.[5] This meeting took place in Geneva from 22 to 26 March 2010. Contrary to earlier expectations, the meeting was convened at the level of senior officials and not at the Ministerial level. In his opening address, Director-General Lamy expressed the wish that after the meeting, Members would "be able to send a strong signal to the outside world and focus the political energy that is needed to move the Round into a concluding phase".[6] As would be seen below from the Chairpersons' reports, there has not been any significant movement in almost all the negotiating areas since the publication of the previous article making it unlikely that the negotiations would be completed in 2010.

Remaining Issues in the Various Negotiating Areas

Agriculture

As made clear in the earlier article, while significant progress has been made on the domestic support and export competition pillars, there are a number of difficult issues remaining under the market access pillar. In his report to the TNC, Chairman David Walker said that since assuming the chairmanship of the Special Session of the Committee on Agriculture, work had proceeded mainly on two levels, namely (i) consultations with Members on the issues that are bracketed in the 6 December 2008 draft modalities text and those which are the subject of separate texts being considered by the Special Session; and (ii) the development of "templates" for the presentation of data which would form the basis for the development of modalities and eventually Members' schedules of commitments.

Market Access Pillar

With respect to sensitive products, it would be recalled under the draft modalities text, it is foreseen that developed countries would be able to designate 4% of their tariff lines as sensitive and make lesser cuts on the selected products. Where 30% of a Member's tariff lines fall in the top band, that Member would be entitled to designate an additional 2% of its tariff lines as sensitive taking the total to 6%. Canada and Japan had pressed for further flexibilities, but other Members were opposed. The Chairman reported that Members' positions on this issue had not evolved. Regarding special products, it is envisaged that developing countries would be able to designate 12% of their tariff lines as special products on the

[5] See Chairman's summary at the concluding session of the Seventh Ministerial Conference, WT/MIN(09)/18; 2 December 2009.

[6] See statement by Pascal Lamy to the Trade Negotiations Committee on 24 July 2009, http://www.wto.org/english/news_e/news09_e/tnc_dg_stat_24jul09_e.htm.

basis of food security, rural development and livelihood security. Five per cent of the tariff lines would not be subjected to any cuts at all, while for the remaining tariff lines the average cut shall not exceed 11%. There has not been any significant movement on this issue, as some developing countries still continue to believe that the proposed numbers are not adequate. The Chairman also reported that there has not been any progress on the Special Safeguard Mechanism (SSM) issue even though there have been several technical contributions from Members on a range of issues, including seasonality, price and volume cross-check. He stated that the SSM issue was "clearly one of the more politically charged issues under discussion".

On tropical and diversification products, the Chairman reported significant progress following the agreement on bananas between the European Union and Latin American suppliers. However, they were still some outstanding issues relating to how the details of that agreement may be translated into modalities. With respect to tariff capping, it had been proposed that developed-country Members should only be able to impose a tariff in excess of 100% only on products designated as sensitive. Japan and some other Members are strongly opposed to this proposal and apparently their positions have not evolved. There is also disagreement on the payment options, should this exception be allowed. On whether it should be possible for new tariff quotas to be created, there has not been any significant change in Members' positions with some insisting that it would be a retrograde step if it were allowed.

Domestic Support Pillar

The Chairman reported that there has not been any significant movement on the cotton issue, with some Members opposed to the language in the draft modalities text, which would require deeper cuts to cotton subsidies. He stated, however, that all the Members involved in the discussions were committed to finding a solution that would address the issue of cotton "ambitiously, expeditiously and specifically" consistent with the Hong Kong Ministerial Declaration.[7] Regarding product-specific limits under the Blue Box, he suggested that a political decision has to be made regarding the bracketed numbers in the relevant paragraph.[8]

Export Competition Pillar

Although significant progress has been made on issues under this pillar, there are a few outstanding issues which need to be resolved, including the monetization of food aid and whether the monopoly powers of agricultural state trading enterprises should be prohibited or disciplined. The fact that the Chairman did not report on these issues could probably be interpreted that they are not deal breakers.

[7] TN/AG/25, 22 March 2010, para. 13.
[8] TN/AG/25, 22 March 2010, para. 11.

NAMA

It would be recalled that significant progress has been made in the NAMA negotiations, with broad agreement on a number of issues, including the formula, the coefficients to be used by developed and developing countries, the treatment of unbound tariffs and flexibilities for countries which have bound less than 35% of their tariff lines. Among the issues on which further work is required are sectorals, flexibilities for certain developing-country Members and non tariff barriers. In his report, the Chairman drew a distinction between “wagon 1 proposals”, including those that had been identified in the draft modalities text as warranting special attention, and “wagon 2” proposals. While good progress has been made on the former proposals, the same could not be said of the latter warranting further consultations to decide on how to handle them after the stock-taking exercise.[9]

Regarding sectorals, it would be recalled that it had been agreed that participation would be voluntary and that the results would be extended to all WTO members on an MFN basis. The basic issue is whether certain developing-country Members would have to commit to participating in some sectoral negotiations. The Chairman reported that detailed technical work had been undertaken by proponents “with a view to engaging with their trading partners on a factual basis with numbers, sector-by-sector simulations, and country-by-country analysis”,[10] but he did not indicate whether Members were close to an agreement. He also reported that discussions with certain Members, namely South Africa, Argentina and Venezuela, on flexibilities from the formula were still ongoing. He further noted that there was some discontent over the language in the draft modalities text on non-reciprocal preferences.

The Chairman said that the main problem in the NAMA negotiations was the perception by some Members that the draft NAMA package was not ambitious enough. These Members had sought to increase the level of ambition by pursuing bilateral and/or sectoral negotiations with certain emerging economies, who believe that the NAMA draft text strikes a careful balance between the interests of all Members.[11]

Services

It would be recalled that one of the main issues in the services negotiations is the quality of offers on the table. The scope and breadth of some of the offers are very

[9]TN/MA/22, 22 March 2010, paras. 1.2–1.8.

[10]TN/MA/22, 22 March 2010, para 1.9.

[11]TN/MA/22, 22 March 2010, para. 2.2.

limited and do not even match current access conditions. Some Members have placed excessive limitations on their offers and others are unwilling to remove current restrictions in their schedules. Generally, developed countries would like developing countries to provide greater access, particularly under modes 1 and 3, in sectors of interest to their services providers, including financial services, telecommunications and professional services, while developing countries would like to see greater commitments in mode 4 and the implementation of specific measures which would enhance their participation in services trade. The negotiations on domestic regulations and GATS rules have also been proceeding at a glacial pace.

In his report to the TNC, the Chairman of the Services negotiations pointed out that based on thorough discussions with WTO Members, he was of the view that there had "been little or no significant progress in the market access negotiations since July 2008".[12] He continued by stating that "gaps in sectoral coverage and levels of commitment needed to be filled in order for members to be satisfied with the outcome of the services negotiations".[13] He also alluded to the fact that progress in the services negotiations was linked to developments in other areas of the DDA negotiations, particularly agriculture and NAMA.

On domestic regulation, the Chairman noted that Members were agreed that a satisfactory outcome of the negotiations on domestic regulation was important in ensuring the effectiveness of scheduled commitments. Whereas the draft text of the Chairperson of the Working Party on Domestic Regulation had been well received by Members, there were still important gaps to be filled. In that context, Members found the Chairperson's annotated text very useful, as it provided them with a tool box to make progress on the outstanding issues.[14]

Regarding GATS rules, he reported that there has not been any significant progress in all the three areas, namely subsidies, emergency safeguards and government procurement. On subsidies, he said while the majority of Members regarded the adoption of the Work Programme for the Exchange of Information by the Working Party as a positive step, negotiations on the critical issues were yet to begin. It is hoped that the information exchange would lead to clarification of the issues on which members should focus on. With respect to emergency safeguards, a great deal of technical work had been done, but there were still wide differences among Members on the issues under consideration. Regarding government procurement, while there had been focused discussions in recent months, there was a political divide on the desirability of including government procurement-related market access commitments into the framework of the GATS.[15]

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[12] TN/S/35, 22 March 2010, para. 6.

[13] TN/S/35, 22 March 2010.

[14] TN/S/35, 22 March 2010, paras. 7–9.

[15] TN/S/35, 22 March 2010, paras. 10–14.

Development

It will be recalled that pursuant to paragraph 44 of the Doha Ministerial Declaration, developing countries tabled 88 agreement-specific proposals with a view to making current special and differential treatment (SDT) provisions more precise and legally enforceable. Developing countries have long insisted that the hortatory character of SDT provisions has meant that they are not implemented by developed countries, thus defeating the purpose for which they were inserted into the multilateral trade agreements. In his report, the Chairman said that progress had been made on six category I proposals and he believed that agreement could be reached on them in the near future.[16] With respect to Category II proposals, it would appear from the reports submitted to the General Council that there has not been any substantive progress. Regarding the remaining Category I and III proposals, he said that he would be continuing his consultations with a view to making progress in the coming months.[17]

Regarding the monitoring mechanism, the Chairman said that good progress had been made in the consultations on the basis of the text circulated by him. Discussions had focused mainly on the structure, scope and functions of the monitoring mechanism. There was now greater clarity on the legal status of the preamble in relation to the operative parts and it appeared that Members were attracted to the idea of attaching a list of provisions which would be subject to review under the monitoring mechanism.[18]

Rules

The Chairman of the Negotiating Group on Rules noted that while significant progress had been made on a number of technical issues as reflected in his December 2008 texts, there were still a number of issues on which it had not been possible to achieve convergence. With respect to anti-dumping, he listed 11 issues in respect of which there were wide divergences in Members' positions justifying the withdrawal of the proposed language in the texts. These included zeroing, causation of injury, material retardation, the exclusion of related producers, product under consideration, information requests to affiliated parties, public interest and lesser duty, anti-circumvention, sunset reviews, third country dumping, special and differential treatment and technical assistance.[19] While the remaining

[16]TN/CTD/25, 22 March 2010, p2.

[17]TN/CTD/25, 22 March 2010.

[18]TN/CTD/25, 22 March 2010.

[19]TN/RL/24, 22 March 2010, para. 3.

issues were not as quite difficult as the 11 issues, there was still some work to do to narrow the gaps in Members' positions.[20]

Regarding horizontal subsidies, he noted that there were less contentious issues than in anti-dumping. However, there were four issues on which Members' positions were far apart. These included certain financing by loss-making institutions, export competitiveness, export credits – market benchmarks and export credits – successor undertakings.[21] Other difficult issues included unregulated pricing, pass-through and subsidy allocation. The Chairman's overall assessment was bleak as far as these two areas were concerned: "we are no nearer consensus on the big political issues than were in December 2008, and we are not likely to see the type of engagement that could lead participants to negotiate compromises on these issues until the overall direction of the Round becomes clearer".[22]

With respect to fisheries subsidies, the Chairman recalled that his December 2007 text had proposed the prohibition of subsidies which led to overcapacity or over-fishing. It also contained a number of exceptions, as well as provisions on fisheries management conditionalities and special and differential treatment for developing countries. He acknowledged that his text was as controversial as the texts on antidumping and horizontal subsidies and that it was obvious that further work was required to bridge the differences in Members' positions. He welcomed the new texts proposed by members and said that some of them offered new approaches which could be helpful in forging consensus.[23]

Regarding regional trade agreements (RTAs), he said that Members were divided as to when the review of the new transparency mechanism for RTAs should be completed. Furthermore, there had been no progress on the systemic issues given the lack of textual contributions from Members.[24]

Trade Facilitation

It would be recalled that the mandate in the trade facilitation negotiations is to clarify and improve Articles V, VIII and X of the GATT 1994. Although the negotiations only started in October 2004, considerable progress has been made leading to the speculation that they could become a candidate for early harvest. Progress in the negotiations could be attributed to the acceptance by all countries, including least-developed countries that it was in their own interest to adopt trade facilitation measures to simplify trade rules and reduce red tape which increase the cost of doing business and in the process scare away foreign direct investment.

[20]TN/RL/24, 22 March 2010.

[21]TN/RL/24, 22 March 2010, para. 4.

[22]TN/RL/24, 22 March 2010, para. 6.

[23]TN/RL/24, 22 March 2010, paras. 9–15.

[24]TN/RL/24, 22 March 2010, paras. 16–19.

Another reason why the negotiations have progressed well is the understanding that implementation of any resulting obligations would be linked to the capacity of a country to so. This guarantee has encouraged developing countries to be very forthcoming in the negotiations.

In his report to the TNC, the Chairman of the Negotiating Group on Trade Facilitation said that the circulation of a draft consolidated text marked an important point in the negotiations, as it "gave a fresh impetus to Member' participation and added a layer of intensity to the negotiation. It allowed delegations to focus on textual modifications as opposed to input in more general form".[25]

The Chairman cautioned, however, that there was more work to be done, as a number of issues had only been partially addressed in the text. He stressed on the importance of a balanced text and said that there ought to be "matching levels of progress on all elements of the text. Advancements on the S&D pillar have to catch up with the rest".[26] He concluded by saying that technical discussions had to translate into a greater amount of actual modifications of the negotiating text.[27]

TRIPS–Multilateral System of Notification and Registration of Geographical Indications (GI) for Wines and Spirits

It would be recalled that the main issues in the negotiations for a Register of GIs are whether participation in the system should be mandatory, and whether the registration of a GI should create a rebuttable presumption that it would be protected in other WTO Members, except in a country that has lodged a reservation within a specified period.

In his report, the Chairman of the Special Session of the Council for Trade-Related Aspects of Intellectual Property summarized the state of the negotiations as follows: on legal effects/consequences of registration and participation, he said that there were profound differences in Members' positions and that further work was required to bridge the differences; on notification and registration, he noted that considerable technical work had been done, but further work was also required in light of the linkage with the earlier issue of legal effects and participation; on issues such as fees, costs and administrative and other burdens, and special and differential treatment, which were of importance to developing countries, he said that they had not been discussed in detail and that further discussions were warranted.[28]

[25]TN/TF/7, 22 March 2010, para. 1; The draft consolidated text has since been revised and circulated as TN/TF/W165/Rev1, 2 March 2010.

[26]TN/TF/7, 22 March 2010, para. 2.

[27]TN/TF/7, 22 March 2010, para. 5.

[28]TN/IP/20, 22 March 2010, para.6.

To make substantive progress in the negotiations, the Chairman suggested that the Special Session continue to structure its work around the three clusters of issues identified by his predecessors, and address to the extent possible the four questions on legal effects, participation and special differential treatment posed by ex-Chairman Trevor Clarke bearing in mind his five guiding principles.[29] He said that the negotiations were being hampered by the lack of a consolidated text which reflected both the differences in Members' positions and the different nature of the proposals on the table.[30]

Trade and Environment

It would be recalled that paragraph 31(i) provides for negotiations on the relationship between existing WTO rules and specific trade obligations (STOs) set out in multilateral trade agreements (MEAs). It further provides that the negotiations would be limited in scope to the applicability of the relevant WTO rules among the parties to the MEAs in question. Paragraph 31(ii) mandates Members to draw up procedures for regular information exchange between MEA Secretariats and the relevant WTO Committees, and the criteria for the granting of observer status. Paragraph 31(iii) provides for negotiations aimed at reducing or, as appropriate, eliminating tariff and non-tariff barriers on environmental goods and services.

With regard to paragraph 31(i), the Chairman of the Special Session of the Committee on Trade and Environment (CTESS) said that ideas put forward by Members in their proposals could be classified in five clusters, namely (a) national coordination to enhance the mutual supportiveness of trade and environment; (b) how CTESS discussions on STOs set out in MEAs could be reflected in an outcome; (c) dispute settlement/legal principles; (d) technical assistance; and (e) general

[29]To focus discussions, Members have been expressing their views on the following four questions formulated by the former Chairman of the Special Session: (i) what legal obligations would be acceptable for the Register to facilitate the protection of GIs for wines and spirits, as mandated by article 23.4 of the TRIPS Agreement, (ii) when making decisions regarding the registration and protection of trademarks and GIs, what significance and weight should national authorities give to the information on the Register? (iii) are there any options regarding participation, other than voluntary and mandatory participation? If so, what criteria could be envisaged? and (iv) what form could SDT take with regard to the register?, TN/IP/20, 22 March 2010, p. 2. Based on the responses the former Chairman formulated the following guiding principles to steer the negotiations: (i) the purpose of the Register is to facilitate, not to increase, the protection of GIs for wines and spirits, (ii) the Register should be useful and meaningful to both notifying Members and consulting Members, (iii) the territorial nature of intellectual property rights should be preserved, (iv) the Register should not impose undue financial and administrative burdens on Members, and (v) SDT should be precise, effective and operational, TN/IP/20, 22 March 2010, p. 3.

[30]TN/IP/20, 22 March 2010, para. 14.

principles. While focused discussions had taken place on these elements, further work was required in order to move to text-based negotiations.[31]

With respect to paragraph 31(ii), the Chairman said that the negotiations were relatively advanced, as Members had identified elements that could be included in an outcome. There were, however, some outstanding issues, including whether observer status should automatically be granted to an MEA Secretariat which had participated in the previous work of the Committee on Trade and Environment.[32]

With respect to paragraph 31(iii), the Chairman stated that progress had been made in identifying eligible environmental products following the introduction of new proposals by Members and the holding of two workshops on Environmental Goods and Services, which enabled Members to share national experiences, enhance their knowledge about this sector, as well as the use of environmental technologies in different environmental activities. Notwithstanding this progress, there were a number of issues which required further work. The issue of which approach should be used to reduce or eliminate tariffs and NTBs was, for example, still open. Discussions on development-related issues were still at a rudimentary stage and needed to be intensified.[33]

Dispute Settlement

The mandate given by Ministers was to improve and clarify the DSU on the basis of work done thus far, as well as any additional proposals by Members. Given the strategic importance of the dispute settlement system, the negotiations were excluded from the "single undertaking" and given a shorter time-frame. They were supposed to have been concluded in May 2003, but they are still dragging on. It has been suggested that WTO Members are satisfied with the operation of the DSU and as such they are not in a hurry to introduce changes which may undermine its effectiveness. It has also been surmised that Members have made a linkage with the other negotiations under the DDA and that the difficulties in agriculture and NAMA have also affected the tempo of the DSU negotiations.

In his report to the TNC, the Chairman noted that Members had accepted the consolidated draft text which he had circulated in July 2008 as the basis for further work. In fact, the Special Session had discussed the entire draft legal text in a systematic manner.[34] While some issues had been clarified through this process, there were still a number of outstanding issues on which consensus had eluded the

[31]TN/TE/19, 22 March 2010, paras. 3–5.

[32]TN/TE/19, 22 March 2010, paras. 6–9.

[33]TN/TE/19, 22 March 2010, paras. 10–20.

[34]TN/DS/24, 22 March 2010, para. 3. The draft legal text is circulated as JOB(08)/81, 18 July 2008.

membership. As noted by the Chairman, "[o]verall, we have achieved only limited concrete progress over the past year in reaching further convergence on the various issues under discussion".[35]

Concluding Remarks

It is clear from the foregoing that not much progress has been made in the Doha negotiations since the July 2008 Ministerial meeting in Geneva. While the financial crisis affected the momentum in the negotiations for the most part in 2009, there is no clear evidence that it resulted in Members hardening their positions on some the key negotiating issues. As put by the Chairman of the NAMA negotiations, the basic problem in the NAMA negotiations, which is also applicable to the other market access negotiations, is the perception by some Members that the market access results are not ambitious enough to enable their countries benefit from the Round. The United States has repeatedly demanded that emerging economies such as Brazil, China and India should assume more obligations in order for the Round to live up to its name of being a Development Round. These countries have responded by saying that the current draft texts in agriculture, NAMA and services strike a careful balance between the interests of all Members and that they cannot assume any more obligations.

It is evident that for substantive progress to be made, all Members, particularly developed countries and emerging economies, should move from their entrenched positions in the various negotiating areas, particularly agriculture, NAMA and services. While there is scope for technical work to continue in some of these areas to further clarify issues, what is really needed at this stage is the political commitment to tackle and resolve the few intractable issues. Without that it would be difficult to envisage substantive progress in the coming months. The danger is that the longer it takes to resolve these outstanding issues, the temptation for Members to reopen the agreed texts. A grand bargain can only be struck if the leading trading nations exercise political leadership and see beyond their own narrow interests. Other countries should not also shirk their responsibilities by looking to the leading nations to resolve all the outstanding issues. They should also be prepared to take on reasonable commitments taking into account the level of their development.

A strengthened multilateral trading system would benefit all countries, particularly the leading nations and also offer an opportunity to least-developed and other poor developing countries to diversify their economies and achieve sustainable growth and development. The importance of a rules-based multilateral trading system became evident at the height of the financial crisis. It restrained WTO Members from adopting blatant protectionist measures which would have escalated

[35]TN/DS/24, 22 March 2010, para. 3.

the crisis and made it difficult for the global economy to recover. The dedicated monitoring mechanism established by the WTO to follow closely the responses of Members to the financial crisis has been widely praised for its deterrent effect. The system faces new challenges and unless it is revamped to reflect closely the developments in the global economy, it would lose its relevance. All Members have a responsibility to ensure that this public good serves effectively the community of nations. The task is not for a few but for all countries. Trade is not a zero sum game and WTO Members should rise to the challenge and make the necessary compromises which would pave the way for the conclusion of the Round. What is already on the table is enormous and countries should work hard to bridge their differences on the few remaining issues.

WTO Dispute Settlement – The Establishment of *'Binding Guidance'* by the Appellate Body in *US Stainless Steel* and Recent Dispute Settlement Rulings

Andreas Krallmann

Introduction

The Marrakesh Agreement Establishing the WTO (hereafter WTO Agreement) together with the multilateral and plurilateral agreements of the WTO lay out the framework of WTO law. Having only been in existence since 1995 as the successor of the GATT, the WTO is still a relatively young international organisation. Consequently, many concepts and definitions of WTO law are still vague and have not yet been clarified in detail. In practice, the Appellate Body (hereafter AB) and panel rulings[1] are therefore of paramount importance in understanding WTO law. Special importance needs to be attached to the decisions of the AB as the permanent instance of appeal for trade disputes, which will lead to a growing and – hopefully consistent understanding of the WTO agreements.

The Role of the WTO Dispute Settlement for WTO Law

According to Article 3.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereafter DSU) the dispute settlement system of the WTO serves to 'clarify the existing provisions of those agreements in accordance

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[1] All reports are publicly available on the WTO website, http://www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_20, © Springer-Verlag Berlin Heidelberg 2011

with customary rules of interpretation of public international law'. It is a quasi-judicial, rules-based system.[2] Article 3.2 of the DSU continues that it must, however, neither add to nor diminish the rights of members. The monopoly of the agreements' interpretation is still reserved for the members themselves: According to Article IX.2 of the WTO Agreement, the Ministerial Conference and the General Council still have the exclusive authority to adopt *authoritative* interpretations of the WTO Agreement and the multilateral agreements. These authoritative interpretations, although never applied so far in practice, need to be distinguished from the dispute settlement's interpretation.[3]

The rulings of the panels and the AB are adopted by members as comprised in the Dispute Settlement Body (DSB). The DSB, in fact, is the General Council which discharges the responsibilities provided for in the DSU.[4]

The adoption of a decision can only be avoided if (i) the whole membership, including the winning member, objects to the adoption of the report, if (ii) one of the parties appeals a panel report[5] or if (iii) the parties involved in the dispute agree to a solution before it is put forward for adoption.[6] As a result, it is very unlikely that any ruling would not be adopted since at least the winning member would usually ask for the adoption of the report. The panel and AB members can therefore expect their decisions to be adopted by members. The WTO dispute settlement has consequently been described as 'quasi-automatic'.[7] Reports must, however, honour the aforementioned limits imposed by Articles 3.2 and 19.2 of the DSU, according to which rights and obligations may not be altered.

In practice, therefore, the meaning of adopted reports of the AB and panels must not be underestimated for the interpretation of WTO law. The clarification of dispute settlement rulings effectively serves to clarify WTO law. Recent decisions of the AB and panels will therefore be discussed in this chapter to see how the understanding of WTO law has evolved over the past year.

[2]Marceau, Consultations and the Panel Process in the WTO Dispute Settlement System, in: Yerxa/Wilson (eds.), *Key Issues in WTO Dispute Settlement – The First Ten Years*, 2005, p. 29 (29).

[3]Ehlermann/Ehring, The Authoritative Interpretation in the WTO Agreement, JIEL 8 (2005) 4, p. 803 (803–804); Gazzini, Can Authoritative Interpretation Under Article IX:2 of the Agreement Establishing the WTO Modify the Rights and Obligations of Members?, ICLQ 57 (2008) 1, p. 169 (170).

[4]Mueller-Holyst, The Role of the Dispute Settlement Body in the Dispute Settlement Process, in: Yerxa/Wilson (eds.), *Key Issues in WTO Dispute Settlement – The First Ten Years*, 2005, p. 25 (25).

[5]Cf. Articles 16.4, first sentence and Article 17.14 of the DSU.

[6]Cf. Article 12.7 of the DSU.

[7]Marceau, Consultations and the Panel Process in the WTO Dispute Settlement System, in: Yerxa/Wilson (eds.), *Key Issues in WTO Dispute Settlement – The First Ten Years*, 2005, p. 29 (29).

Brief Overview: The Different Types of Rulings and Stages of Dispute Settlement

Hierarchy

In terms of hierarchy, the DSU constitutes a two level mechanism: After concluding the mandatory consultation phase unsuccessfully, the disputing members can ask for the establishment of a panel as the first instance. According to Article 8 of the DSU, a panel is usually composed of three trade experts on an ad hoc basis.

After issuing their ruling as a panel report, the parties to the conflict may appeal to the AB.[8] Article 17.6 of the DSU limits the appeal to 'issues of law covered in the panel report and legal interpretations developed by the panel'. Article 17.13 of the DSU grants the AB the right to uphold, modify or reverse the legal findings of a panel.[9] There is no possibility to appeal a ruling of the AB.

Different Stages

The DSU also foresees different stages of dispute settlement and arbitration.[10] If the panel or AB finds in its material decision that a member's measure is inconsistent with WTO law, it makes a recommendation to that member to bring its measures into conformity with WTO law again.[11] That is, however, often not the end to a dispute. Disputes frequently continue even after a panel or the AB has decided upon the case itself.

Article 21.1 and 21.3 of the DSU stipulate that the parties need to implement the decision promptly. However, in most cases the losing member will ask for the granting of a reasonable period of time (hereafter 'rpt') in order to be able to comply with the ruling and implement it accordingly. If the parties are not able to mutually agree on an rpt, they can refer the case to arbitration on how long this rpt should be, as stipulated in Article 21.3 lit. c of the DSU.

After a report has been issued with recommendations to the parties to comply with the rulings and, eventually, after the rpt has ended, parties may start yet another legal procedure on the question whether the member that lost its case complied with the rulings of the report. According to Article 21.5 of the DSU,

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[8]Article 17 of the DSU lays down the requirements for the AB.

[9]The typical wording reads "... the DSB adopted the AB report on… and the panel report, as modified by the AB report. The panel report should be read in conjunction with the AB report". Cf. e.g., WT/DS343/14.

[10]A detailed overview on the procedures can be found in the WTO Secretariat publication, A Handbook on the WTO Dispute Settlement System, 2004; relevant texts are contained in the WTO Secretariat publication, *The WTO Dispute Settlement Procedures*, (2nd ed.) 2001; van den Bossche, *The Law and Policy of the World Trade Organization*, (2nd ed.) 2008, pp. 269–307.

[11]Article 19.1 of the DSU.

such a compliance panel is given 90 days to decide if the losing party complied in substance with the recommendations and rulings of the case. The decision of a compliance panel can be appealed to the AB.

If a party does not comply with the recommendations and rulings of the DSB and is still in breach of its WTO obligations, the other party will be allowed to ask for the granting of an authorisation to suspend concessions or other obligations. This allows members to enforce the decisions of the WTO dispute settlement mechanism. If the parties do not agree on the proposed level of suspension, the matter may be referred to arbitration as laid down in Article 22.6 of the DSU.

Binding Guidance: The 2008 AB Ruling *US – Final Anti-Dumping Measures on Stainless Steel from Mexico*

As discussed earlier, it remains the exclusive authority of the Ministerial Conference and the General Council to adopt interpretations that are binding upon the whole WTO membership. However, the practical importance of the jurisprudence of panels and the AB was also touched upon.

Since the AB as the body of appeal can overrule the panels' findings,[12] the question arises whether the AB can set binding precedent for future cases.

It is or might critically be added *was* well established jurisprudence that AB reports only resolve the particular dispute between the parties involved and are not generally binding.[13]

Already in the past, however, the AB also saw its rulings as creating certain legitimate expectations among WTO members so that subsequent panels should take adopted reports into account where they were relevant to any given dispute.[14] In *US Oil Country Tubular Goods*, the AB held that it would not only be appropriate but expected from a panel to take prior rulings into account, 'especially where the issues are the same'.[15] Even before the decision in *US Stainless Steel,* AB jurisprudence had therefore had a certain general effect which encouraged panels to take prior AB interpretation into account. It raised the expectation that panels would follow the line taken by the AB. This practice by the WTO dispute settlement

[12] Article 17.13 of the DSU.

[13] AB *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, pp. 12–15; AB *US – Final Dumping Determination on Softwood Lumber from Canada*, WT/DS264/AB/R, paras. 109–112; AB *US – Import Prohibition of Certain Shrimp and ShrimpProducts (Article 21.5)*, WT/DS58/AB/RW, para. 109.

[14] AB *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, p. 14 established this line for panel reports; AB *US – Import Prohibition of Certain Shrimp and Shrimp Products (Article 21.5)*, WT/DS58/AB/RW, para. 109 extended this line to AB rulings.

[15] AB *US – Sunset Reviews of Anti-Dumping Measures Oil Country Tubular Goods from Argentina*, WT/DS268/AB/R, para. 188.

made Bhala conclude as early as in 2001 that 'like it or nor not, precedent, or stare decisis, in the Anglo-American sense of the terms, is alive and well in practice of the AB'.[16]

In 2008, another zeroing case had to be decided in *US Stainless Steel*. The AB had decided several times in the past that the application of the zeroing methodology is inconsistent with the Anti-Dumping Agreement (AD Agreement). Zeroing is a methodology which is used for the calculation of anti-dumping margins. The effect is that the margin of dumping is artificially increased by disregarding certain imports which would not be qualified as dumped if they were assessed separately on their own.[17] Against this background of a consistent AB jurisprudence on zeroing, the panel in *US Stainless Steel* nevertheless decided to depart from this well established jurisprudence of the AB.

The panel in *US Stainless Steel* was aware of the above-mentioned expectation to take the AB jurisprudence on zeroing into account. It stated that 'even though the DSU does not require WTO panels to follow adopted panel or AB reports, the AB de facto expects them to do so to the extent that the legal issues addressed are similar'.[18] However, the panel interpreted its duties resulting from Articles 11 and 3.2 of the DSU to find its own objective assessment of the case as being superior to the expectation that it should follow the AB's jurisprudence. It decided contrary to the line taken by the AB and thereby deferred from well established and continuously confirmed clarification by the AB on the concept of 'zeroing'.[19] Although well established by the AB that different methods of zeroing cannot be reconciled with the AD Agreement, the panel at hand nevertheless disagreed and found that zeroing should be permissible.[20] According to the panel, a consistent line of interpretation would not be as important as carrying out an objective interpretation of the relevant WTO law at issue.[21]

This line taken by the panel was subsequently corrected upon appeal. In its ruling and against this background, the AB goes even further than past AB decisions on the binding nature of AB jurisprudence and, one could argue, could cast at least some doubts on the absence of the rule of binding precedent.

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[16]Bhala, Global Trade Issues in the New Millennium: The Power of the Past Towards De Jure Stare Decisis in WTO Adjudication (Part Three of Trilogy), G. Wash. Int'l L. Rev. 33 (2001) 4, p. 873 (978).

[17]See also infra, C.IV.1.

[18]Panel *US – Final Anti-dumping Measures on Stainless Steel from Mexico*, WT/DS344/R, para. 7.105.

[19]Panel *US – Final Anti-dumping Measures on Stainless Steel from Mexico*, WT/DS344/R, para. 7.106, "...we have no option but to respectfully disagree with the line of reasoning developed by the AB regarding the WTO-consistency of simple zeroing in periodic reviews".

[20]Panel *US – Final Anti-dumping Measures on Stainless Steel from Mexico*, WT/DS344/R, para. 7.117.

[21]Panel *US – Final Anti-dumping Measures on Stainless Steel from Mexico*, WT/DS344/R, para. 7.105.

In a rather irritated way the AB corrected the panel ruling and decided that '*absent cogent reasons, an adjudicatory body will resolve the same legal question in the same way in a subsequent case*'.[22] Arguably, this ruling which is not limited to the zeroing problem but which seems to be applicable to all AB jurisprudence establishes a general direction for a future adjudicatory body. Although not explicitly establishing precedent, the AB could have introduced something similar. The European Union, e.g. in a subsequent zeroing case, refers to this decision in the context of precedent: The EU urged the AB 'to consider the present matter in the light of findings in *US Stainless Steel* on the question of '*precedent*''.[23] Also, literature has pointed out that *US Stainless Steel* established 'AB precedent'.[24] Thus, the ruling could be understood to establish at least some precedential effect.

In understanding the AB's ruling and its effect, one important question that arises is what precisely is meant by 'an adjudicatory body'. There are several interpretations possible. Adjudicatory body could be a synonym for panel, which would mean that a panel is obliged to follow another panel's point of view if faced with an identical question of law. It could, however, also mean that future panels will have to follow AB jurisprudence but would be free to disagree with other panels' legal interpretations. Lastly, adjudicatory body could be interpreted as referring solely to the AB, which would mean that only the AB can establish cogent reasons to divert from its previous own AB jurisprudence.

The solution should be found in systematically reading and interpreting the AB's ruling. Since the AB starts its ruling by clarifying that 'the legal interpretation embodied in adopted panel and AB reports' become part of the WTO acquis,[25] the definition of 'adjudicatory body' would prima facie include future panels and the AB alike. In the following paragraph of the report, however, the reasoning of the AB only refers to the hierarchical structure of the dispute settlement system. It concentrates purely on the AB's role as the permanent body of appeal and explicitly points out that the panels and the AB 'have distinct roles to play'. According to the AB, members were aware of the need for a consistent interpretation of the WTO agreements when they created the AB as the body of appeal. The AB's commission was and is to review the panels' legal interpretations with the power to revert or modify the panels' rulings if necessary. Thereby, the very creation of the AB was meant to promote security and predictability in the dispute settlement system.[26] Thus, by emphasising the hierarchical structure it arguably

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[22] AB *US – Final Anti-dumping Measures on Stainless Steel from Mexico*, WT/DS344/AB/R, para. 160.

[23] EU in AB, *US - Continued Existence and Application of Zeroing Methodology*, WT/DS350/AB/R, paras. 106, 262.

[24] Jackson/Davey/Sykes, *Legal Problems of International Economic Relations*, (5th ed.) 2008, p. 318: "What can a panel do if it disagrees strongly with Appellate Body precedent?".

[25] AB *US – Final Anti-dumping Measures on Stainless Steel from Mexico*, WT/DS344/AB/R, para. 160.

[26] AB *US – Final Anti-dumping Measures on Stainless Steel from Mexico*, WT/DS344/AB/R, para. 161.

becomes clear that panels must not defer from AB jurisprudence, which is at the top of the WTO dispute settlement system. Unlike the AB, future panels will still be on the same level of hierarchy as every other panel in the past or future. It can therefore not be argued that the AB wanted to allocate precedential or binding effect to all panels' rulings. If the reason for the binding nature of rulings is the hierarchy of the WTO dispute settlement system, it can only relate to the AB as the top authority. This is confirmed by the AB when it concludes its reasoning: The AB ends its explanation by emphasising that 'the relevance of clarification contained in adopted AB reports is not limited to the application of a provision in a specific case'.[27] In other words, *AB* interpretation of law in a specific case is of general meaning for future panels. Since panel reports are not mentioned here any more, the binding nature is, arguably, only applicable to the AB jurisprudence and not to panel reports.[28]

Another question is whether this implies that cogent reasons which justify diversion from a previous line can only be established by the AB itself or if panels can decide that cogent reasons make them disagree with a previous interpretation of the AB. One view is that the decision in *US Stainless Steel* means that only the AB can reverse its previous decisions 'for new and cogent reasons'.[29] The decision has been interpreted to mean that 'a panel may invoke cogent reasons in order to depart from previous panel findings; but only the AB can invoke cogent reasons in order to depart from previous AB findings'.[30] It is argued that the use of the phrase 'adjudicatory body' in the singular is meant to refer to a situation 'in which it is the same body in both the previous case and the case to be decided'.[31] This view, however, is not mandatory. Arguably, the decision contains too little guidance to give precedential effect to panels' rulings as well and to restrict panels to depart from AB jurisprudence even if new and cogent reasons occur. Referring to the use of the singular to interpret that panels can never depart would be a far reaching consequence. As explained before, the term adjudicatory body needs to be interpreted in the light of the AB's reasoning. The overarching theme in the reasoning is that members decided that the AB as a permanent body of appeal should be at the top of the hierarchy of the WTO dispute settlement system. It is the AB that is supposed to control panels' legal interpretations in a coherent manner. As argued above, the binding nature is only applicable to the AB jurisprudence and not to panel reports.[32]

[27] AB *US – Final Anti-dumping Measures on Stainless Steel from Mexico*, WT/DS344/AB/R, para. 161.

[28] Whether this also means that the AB wanted to extend this principle to itself will be left open in this chapter.

[29] See the EU's position in AB, *US - Continued Existence and Application of Zeroing Methodology*, WT/DS350/AB/R, para. 262.

[30] See the EU's position in AB, *US - Continued Existence and Application of Zeroing Methodology*, WT/DS350/AB/R, para. 363.

[31] See the EU's position in AB, *US - Continued Existence and Application of Zeroing Methodology*, WT/DS350/AB/R, para. 363.

[32] Otherwise, panel reports which had not been appealed and thus not controlled by the AB would automatically gain precedential effect for future cases for all members.

Reading the decision in such a way that only the AB can establish cogent reasons to depart from its own prior jurisprudence should be questioned for another reason. It could be expected that the AB is aware of its function and would carefully elaborate on why it defers from a previous line of jurisprudence if it wanted to break with its own jurisprudence, i.e. cogent reasons should be established in any case even without the ruling in *US Stainless Steel*. Also, the principle of collegiality as laid down in para 4 of the Working Procedures for Appellate Review should in itself avoid single decisions of the AB depart from previously established principles. The idea of not following AB jurisprudence is most imminent for panels being established on an ad hoc basis for a single case and not for the permanent body of appeal, the AB. It would not have needed a clarification as spelled out in *US Stainless Steel* to restrict itself. It should be recalled that *US Stainless Steel* dealt with a panel not following AB jurisprudence and not with the correction of AB jurisprudence by the AB itself. The AB wanted future panels to carefully assess a case and only depart after careful consideration and argumentation. Thus, a panel which would like to depart from established AB jurisprudence will have to argue carefully which cogent reasons compel it to decide differently.

Taking into account the duty of every panel which is contained in Article 11 of the DSU, second sentence, i.e. that every panel has to make an objective assessment of the case, it should be possible for a panel to establish cogent reasons to depart from AB jurisprudence. The AB did not diminish this right and obligation of a panel, it just demands to elaborate stringently cogent reasons.

The development of how panels are expected to take into account AB jurisprudence, especially in *US Oil Country Tubular Goods,* will be touched upon later, but this developing line also supports the idea that panels would have freedom to depart if they established cogent reasons.

The principle established by *US Stainless Steel* can thus be understood to mean that future panels will really have to make a serious effort before they can depart from established jurisprudence. Obviously, the efforts taken by the panel in *US Stainless Steel* were not sufficient.

Although the AB should not have the authority to establish a rule of precedent which the DSU does not foresee, the decision in practice leaves little space for manoeuvre for panels to depart from prior AB rulings on the same issue in the future. 'Absent cogent reasons', the decisions of past AB jurisprudence will be quasi-binding if they concern an identical case. The nature of this quasi-binding power of AB rulings will therefore be looked at.

In general, different forms of stare decisis and the rule of *precedent* exist and different schools of thoughts differ on views how strict or liberal the precedential effect should be.[33] Often, the terms stare decisis and precedent are used

[33]Blackmore, Eradicating the Long Standing Existence of a No-Precedent Rule in International Trade Law – Looking Toward Stare Decisis in WTO Dispute Settlement, N.C.J. Int'l L. & Com. Reg. 29 (2004) 3, p. 487 (494).

interchangeably. In reality, however, the degree of precedent can vary between the single common law jurisdictions and sometimes even within a system of precedent.[34] The doctrine of stare decisis is often referred to as a particular strong form of precedent.[35] Common to all these concepts is that judicial rulings are attributed some precedential effect. Thus, the question is whether the AB de facto introduced such a system of precedent when it demanded that the same legal question should be decided in the same way in future cases. The clarification by *US Stainless Steel* might therefore be criticised as coming close to the introduction of such a rule of precedent.

In comparison to the AB's ruling in *US Stainless Steel*, stare decisis in common law has been described as the 'general proposition that a precedent must be followed unless there is *cogent reason* to overrule it'.[36] Still, that both the AB in its ruling and the common law's rule of stare decisis refer to the absence of 'cogent reasons' must not be equated as meaning the same thing or establishing the same principle.

Other than WTO interpretation, judicial decisions in a common law system constitute law.[37] This is not the case in WTO law where the rule of precedent is not applicable.[38] No such rule of stare decisis is foreseen in the DSU. In fact, such doctrine was excluded in the GATT before the WTO was founded and continued to be absent in the WTO dispute settlement.[39] The law of the WTO is no common law.

[34]Jackson/Davey/Sykes, *Legal Problems of International Economic Relations*, (5th ed.) 2008, pp. 194–195 and p. 179.

[35]Jackson/Davey/Sykes, Legal Problems of International Economic Relations, 5th ed., 2008, p. 195.

[36]Blackmore, Eradicating the Long Standing Existence of a No-Precedent Rule in International Trade Law – Looking Toward Stare Decisis in WTO Dispute Settlement, N.C.J. Int'l L. & Com. Reg. 29 (2004) 3, p. 487 (504).

[37]Malleson, *The Legal System*, (2nd ed.) 2005, p. 75; Blackmore, Eradicating the Long Standing Existence of a No-Precedent Rule in International Trade Law – Looking Toward Stare Decisis in WTO Dispute Settlement, N.C.J. Int'l L. & Com. Reg. 29 (2004) 3, p. 487 (495).

[38]Blackmore, Eradicating the Long Standing Existence of a No-Precedent Rule in International Trade Law – Looking Toward Stare Decisis in WTO Dispute Settlement, N.C.J. Int'l L. & Com. Reg. 29 (2004) 3, p. 487 (498); Bhala, Global Trade Issues in the New Millennium: The Power of the Past Towards De Jure Stare Decisis in WTO Adjudication (Part Three of Trilogy), G. Wash. Int'l L. Rev. 33 (2001) 4, p. 873 (978) is of a different view.

[39]Blackmore, Eradicating the Long Standing Existence of a No-Precedent Rule in International Trade Law – Looking Toward Stare Decisis in WTO Dispute Settlement, N.C.J. Int'l L. & Com. Reg. 29 (2004) 3, p. 487 (489); Nielsen, *The WTO, Animals and PPMs*, 2007, p. 115; Chua, Precedent and Principles of WTO Panel Jurisprudence, Berkeley J. Int'l L. 16 (1998), p. 171 (178); a more in depth study on stare decisis can be found in a trilogy by: Bhala, The Myth About Stare Decisis and International Trade Law (Part One of Trilogy), Am. U. Int'l L. Rev. 14 (1999), 845; Bhala, The Precedent Setters: De Facto Stare Decisis in WTO Adjudication (Part Two of Trilogy), Fla. St. U. J. Transnat'l L. & Pol. 9 (1999) 1, p. 1; Bhala, Global Trade Issues in the New Millennium: The Power of the Past Towards De Jure Stare Decisis in WTO Adjudication (Part Three of Trilogy), G. Wash. Int'l L. Rev. 33 (2001) 4, p. 873.

Stare decisis, however, is a concept of common law.[40] Thus, the doctrine of precedent and accordingly the related terminology does not fit.

In order to avoid the impression that we deal with a common law system, the term 'precedent' should be avoided. Instead of calling it binding-precedent-which is a concept alien to the WTO law – it should in my view be referred to by the oxymoron *binding guidance*. The term seems to contradict itself but captures the ambiguous idea of the AB's concept in *US Stainless Steel*. On the one hand, the principle is mandatory, i.e. binding and does not allow future panels to deviate from AB jurisprudence. That establishes the quasi-compulsory element. On the other hand and contradictorily, future panels will have the freedom not to follow the AB jurisprudence if they can establish cogent reasons. That is the non-mandatory, guiding element of the principle. It guides future decisions but is itself no law and must not inevitably be followed for all future time. Then again, at the same time, it is indeed binding in nature.

The establishment of this binding principle does not come out of the blue. It follows an evolving scheme already described above: Earlier jurisprudence emphasised that panel reports are 'part of the GATT acquis' and should be taken into account.[41] Arguably, taking into account still allowed panels to depart from previous reports if the reasoning was not shared. *US Shrimp* extended this line to AB reports as well.[42] The AB in *US Oil Country Tubular Goods* already tightened the standard and stipulated that panels would be 'expected' to follow AB conclusions if 'the issues were the same'.[43] This already indicates a growing strictness. Nevertheless, this standard still allowed panels not to follow this expectation. With the new line taken in *US Stainless Steel* panels cannot deviate unless they establish cogent reasons. Thus, the freedom of panels narrowed from (i) the obligation to *take into account* previous rulings to (ii) an *expectation to follow* previous jurisprudence into (iii) a *prohibition to depart without cogent reasons*. Future panels will arguably enjoy less own discretion. Therefore, with the principle of binding guidance, a new, even narrower concept has been established.

This can be seen in a subsequent zeroing case. The panel in *US Continued Zeroing* very closely followed the aforementioned reasoning in *US Stainless Steel* and did not defer from the principles laid down in that very decision. The panel critically looked at the newly established principle. It agreed that 'prior adopted reports form part of the GATT/WTO acquis and ... create legitimate expectations'.[44] However, it warned that 'a panel cannot simply follow the adopted report

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[40]Jackson/Davey/Sykes, *Legal Problems of International Economic Relations*, (5th ed.) 2008, p. 195.

[41]AB *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, pp. 12–15.

[42]AB *US – Import Prohibition of Certain Shrimp and Shrimp Products (Article 21.5)*, WT/DS58/AB/RW, para. 109.

[43]AB US – *Sunset Reviews of Anti-Dumping Measures Oil Country Tubular Goods from Argentina*, WT/DS268/AB/R, para. 188.

[44]Panel *US – Continued Existence and Application of Zeroing Methodology*, WT/DS350/R, para. 7.179.

of another panel, or of the AB, without careful consideration'.[45] At the end it cast some doubts on the AB's interpretation of the AD Agreement and the prohibition of zeroing but 'given the consistent adopted jurisprudence on the legal issues' the panel decided that 'providing prompt resolution to the dispute . . . will best serve the multiple goals of the DSU, and, on balance, is furthered by following the AB's adopted findings'.[46] The binding nature of the AB's new ruling in *US Stainless Steel* also resounds in the separate opinion by one member of the panel who clarified that he or she regards zeroing upon 'objective examination' as a prohibited practice and 'not a simple acceptance of the AB's opinion'.[47] Furthermore, the AB realised on appeal, maybe with some relief, that 'the panel does appear to have acceded to the hierarchical structure contemplated in the DSU'.[48]

The guiding nature of AB rulings will allow for more predictability and could avoid costly and time-consuming litigation. Article 3.2 of the DSU sets out that the dispute settlement system is a central element in providing security and *predictability*. Even without having the effect of precedent in the common law sense, the rulings create expectations in members and thereby contribute to stability and predictability.[49] If panels absent cogent reasons refrain from departing from established jurisprudence in the AB, this will definitely strengthen the discipline and predictability of the WTO's dispute settlement.

This strengthened role of predictability should not be underestimated in commercial disputes. A comparison can be drawn to the international sale of goods, where commodity traders usually choose English law as the applicable law.[50] Besides other reasons like tradition, one major alleged advantage of English law is the predictability of its case law which is secured by the doctrine of precedent.[51] Certainty has been described to be the key value of the doctrine of precedent.[52] Commercial players have to rely on a stable jurisdiction to minimise commercial risks. If traders and other commercial agents can rely on predictable outcomes, they

[45]Panel *US – Continued Existence and Application of Zeroing Methodology*, WT/DS350/R, para. 7.180.

[46]Panel *US – Continued Existence and Application of Zeroing Methodology*, WT/DS350/R, paras. 7.181, 7.182.

[47]Panel *US – Continued Existence and Application of Zeroing Methodology*, WT/DS350/R, para. 9.2.

[48]AB *US - Continued Existence and Application of Zeroing Methodology*, WT/DS350/AB/R, para. 365.

[49]Hilf, Power, Rules and Principles – Which Orientation For WTO/GATT Law?, J. Int'l Econ. L. 4 (2001) 1, pp. 111 et seq. (116–117).

[50]Bridge, *The International Sale of Goods*, 1999, p. 2.

[51]Cf. Bhala's similar argumentation in Bhala, Global Trade Issues in the New Millennium: The Power of the Past Towards De Jure Stare Decisis in WTO Adjudication (Part Three of Trilogy), G. Wash. Int'l L. Rev. 33 (2001) 4, p. 873 (931–941).

[52]Harris, Final Appellate Body Courts Overruling Their Own "Wrong" Precedents: The Ongoing Search For Principle, L.Q.R. 118 (2002) 18, p. 408 (413).

can decide and invest accordingly.[53] Thus, if the strengthened authority of AB rulings leads to a higher predictability within the meaning of Article 3.2 of the DSU, WTO case law will become more reliable and foreseeable for WTO members and the members' international traders. 'Absent some form of legal authority or precedential effect, outcomes of cases would lack consistency and predictability' one legal scholar pointed out.[54] With the principle of binding guidance in place, this predictability will increase.

The US have harshly criticised this development. In their view, the AB ruling in *US Stainless Steel* is in breach of Article 3.2 of the DSU since the requirement of panels to 'blindly ... follow erroneous AB conclusions in the name of security and predictability is simply inconsistent with Article 3.2' of the DSU.[55]

However, a legitimate response to this criticism of the AB's rigidity is the question of an alternative to its approach: Can the WTO really afford to have panels continue to disagree with a well established line taken by the AB? Clearly, for the sake of trade, the answer needs to be negative. As already explained, commercial agents need a predictable environment and should not be exposed to unnecessary, time-consuming, avoidable and costly disputes. On the contrary, in the light of the hierarchical system of the DSU, members can expect the panels in general to follow the AB jurisprudence. Again, it was the membership that agreed on the hierarchical structure of the system.

Arguably, much will also depend on what is accepted as 'cogent reasons'. Since this concept is not yet clarified, the true rigidity of the AB's ruling remains outstanding.

In addition, the aforementioned authoritative interpretation according to Art IX.2 of the WTO Agreement can be seen as a possible corrigendum to the dispute settlement rulings, or, as Ehlermann and Ehring put it, well before the ruling of *US Stainless Steel*, 'the quasi automaticity of the adoption of dispute settlement reports makes the authoritative interpretation [by members] a necessary instrument of checks and balance vis-a-vis the WTO's quasi-judiciary'.[56]

Established AB jurisprudence on certain aspects of law could therefore still be reversed by means of members adopting such a clarifying authoritative

[53]Chua, Precedent and Principles of WTO Panel Jurisprudence, Berkeley J. Int'l L. 16 (1998), p. 171 (172–173).

[54]Chua, Precedent and Principles of WTO Panel Jurisprudence, Berkeley J. Int'l L. 16 (1998), p. 171 (172).

[55]US Communication issued after the adoption of *US Stainless Steel* in WT/DS344/11, p. 4; indeed, there is in general a danger that the AB as a quasi-judiciary body will decide on issues of which the members of the WTO were not fully aware when concluding the respective agreement or even stepping over the boundaries of true interpretation of the WTO agreements. This problem, however, is not strictly connected to the binding nature of AB jurisprudence but is inherent in any judicial or quasi-judicial system. The principle of binding guidance could amplify this general problem of jurisprudence since panels might feel that they cannot depart from certain AB jurisprudence.

[56]Ehlermann/Ehring, The Authoritative Interpretation in the WTO Agreement, JIEL 8 (2005) 4, p. 803 (812).

interpretation on a certain question of law, an amendment of the agreement concerned or by a panel or the AB establishing cogent reasons which compel to depart from established AB jurisprudence. In the absence of one of these corrections, AB jurisprudence will gain more weight and be secured by the principle of binding guidance.

Recent Decisions

Bearing in mind the importance of the dispute settlement's clarification of the agreements, this section will give a brief overview of the 2009 cases of WTO dispute settlement. The main factual aspects and selected systemic implications of the findings will be sketched out.[57]

Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights* (DS 362)

Facts of the Case

CHN Intellectual Property Rights is the first of two cases that the US brought against China on the violation of intellectual property rights. The case dealt with three issues, first, the US claimed that China did not provide sufficiently strict criminal procedures and penalties to be applied in cases of wilful counterfeiting or copyright piracy on a commercial scale. Secondly, China's practice of disposing confiscated goods was criticised as not complying with China's obligation under the TRIPS Agreement (hereafter TRIPS). Lastly, the denial of protection of copyright to creative works of authorship for works which have not yet been authorised or which are prohibited from distribution and publication within China was criticised.[58]

Important Aspects of the Findings

Unlike the second case on intellectual property rights involving the US and China, China defended its practice relatively successfully in this case.

On the denial of copyright protection, the panel found that the US failed to make a prima facie case with respect to works never submitted for content review, works

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[57]The WTO Secretariat provides free one-page case summaries for WTO dispute cases at http://onlinebookshop.wto.org/shop/article_details.asp?Id_Article=721&lang=EN.

[58]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, paras. 2.2.–2.4.

awaiting the result of content review and unedited versions of works for which an edited version has been approved for distribution.[59] The panel did not deny a member's right to censorship.[60] However, the panel also found that 'there is no reason to suppose that censorship will eliminate those rights' with respect to a particular work 'entirely'.[61] China was unable to explain why censorship interfered with the copyright owner's rights to prevent third parties from exploiting prohibited works.[62] Thus, in regard to these prohibited works, China was in breach of Article 5(1) of the Berne Convention as incorporated by Article 9.1 of the TRIPS. Furthermore, the panel found a violation of Article 41.1 of the TRIPS.

The panel interpreted Articles 59 and 46 of the TRIPS in some detail in order to assess whether China's practice of dealing with confiscated goods was illegal. The panel clarified that Article 59 of the TRIPS contains no obligation to apply the requirements of Article 59 of the TRIPS to products destined for exportation.[63] In some constellations, like the donation of infringing goods to social welfare bodies, it could not be established that China did not follow the principles of the TRIPS.[64] However, the panel was convinced that the simple removal of a trademark unlawfully affixed to counterfeit goods before releasing of the counterfeit goods into the channels of commerce again was not sufficient since this practice of the Chinese authorities was not limited to exceptional cases.[65] The buyer of the counterfeit goods without the counterfeit trademark could easily reaffix the trademark in order to infringe the intellectual property rights again. Thus, the US could not lay down that China's practice was inconsistent with Article 59 of the TRIPS insofar as it incorporates the principles of Article 46 of the TRIPS, first sentence. China was only in breach of the principles of Article 46, fourth sentence, in conjunction with Article 59 of the TRIPS.[66]

The last part of the decision dealt with the question whether China met its international obligations under the first sentence of Article 61 of the TRIPS or whether the criminal sanctions for wilful trademark counterfeiting and copyright piracy on a commercial scale were not sufficiently severe. The panel recalled the

[59]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, para. 7.103.

[60]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, para. 7.126.

[61]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, para. 7.132.

[62]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, para. 7.133.

[63]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, para. 7.224

[64]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, para. 7.297.

[65]Cf. Article 46, fourth sentence, of the TRIPS.

[66]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, paras. 7.197–7.395.

nature of the TRIPS, which sets minimum standards only.[67] It follows from Article 1 of the TRIPS that the TRIPS does not mandate specific forms of legislation.[68] The panel interpreted the term 'commercial scale' in Article 61 of the TRIPS to mean 'counterfeiting or piracy carried on at the magnitude or extent of typical or usual commercial activity with respect to a given product in a given market'.[69] In the light of this definition, the US submission was not substantive enough to establish that the Chinese criminal thresholds in question were inconsistent with China's obligations deriving from Article 61 of the TRIPS.[70]

State of Play

Since neither of the parties appealed the report, it was adopted by the DSB in March 2009.[71]

Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products* (DS 363)

Facts of the Case

The case is the second which the US brought against China because of alleged violations of intellectual property rights. The comprehensive claim dealt with the importation into and distribution within China of reading materials, audiovisual home entertainment products like video discs, sound recordings and movies for theatrical release. It also included services and service supply concerning some of these products. The claimed that China would inter alia illegitimately restrict import and distribution of the products by discriminating the commercial activities of foreign suppliers, prohibiting master distribution and prescribing more burdensome requirements for foreign firms.[72]

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[67]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, para. 7.513; see also para. 7.180 on the enforcement provisions of the TRIPS.

[68]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, para. 7.602.

[69]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, paras. 7.577, 7.599.

[70]Panel *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/R, para. 7.669.

[71]WT/DS362/11.

[72]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, paras. 2.1–2.2.

Important Aspects of the Findings

China successfully challenged some of the alleged measures as falling outside the panel's terms of reference.[73] However, in substance, the panel largely followed the US argumentation.

In its accession protocol China committed itself to the so-called trading rights, which are the rights to import and export goods. These trading rights are dealt with in accession protocols. This includes the possibility, as the panel logically pointed out, to 'impose obligations on China [like any other acceding country] that are not imposed on other members' or are stricter than those on other members.[74] However, China's protocol of accession also stipulates that its commitments to liberalisation are 'without prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement'.[75] The panel interpreted China's right to regulate trade in a manner consistent with the agreements to take 'precedence over China's obligation to ensure that all enterprises in China have the right to trade'.[76] Consequently, China was allowed to regulate imports and exports of goods in a WTO-consistent way.[77] However, a number of the alleged measures taken by China were not justified by China's right to regulate in that sense and violated the trading rights.[78]

Since China stated that possible violations might be justified as 'necessary to protect public morals' according to Article XX lit. a of the GATT 1994, the panel touched upon two other striking issues. The first question that needed to be solved systematically was whether a justification according to Art XX GATT 1994 can be invoked as a defence to a breach of an obligation of the accession protocol. The reason is that the chapeau of Article XX of the GATT 1994 reads 'nothing in this Agreement [GATT] shall . . .prevent'. The panel followed the approach taken by the AB in *US – Customs Bond Directive* and left the question open since the requirements of lit. a of Article XX of the GATT 1994 were not met.[79]

In determining whether the measures taken by China were necessary to protect public morals, the panel had to address the meaning of the term 'public morals' for

[73]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, para 7.226.

[74]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, para. 7.281.

[75]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, paras. 7.235, 7.305.

[76]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, para. 7.254.

[77]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, para. 7.275.

[78]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, para. 7.706.

[79]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, paras. 7.743–7.745, 7.913–7.915.

the first time in history in the context of Article XX lit. a of the GATT 1994. It concluded that the term 'public morals' had to be interpreted in the same way as the corresponding, identical wording in the GATS. It therefore did not depart from the panel's and AB's interpretation of the term in *US Gambling*. Instead of providing for a strict definition, it coincided with the flexible concept defined in *US Gambling* that 'the term 'public morals' denotes standards of right and wrong conduct maintained by or on behalf of a community or nation'. 'The content of these concepts can vary in time and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values'. According to the panel, members have some discretion to 'define and apply for themselves the concepts of public morals'.[80] The US did not question China's right to perform 'content reviews' but successfully argued that these measures of censorship were not necessary.[81]

Additionally, the panel also found violations of the GATS and Article III:4 of the GATT 1994.

AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products* (DS 363)

On appeal, the AB by and large confirmed the findings of the panel. Unlike the panel, however, the AB answered the question whether China could in general invoke Article XX of the GATT 1994 to justify restrictions of its trading rights. It answered the question in the positive but agreed with the panel that the concrete restricting measures of the Chinese government were not necessary and thus not justified.

In contrast to the panel's approach and its own practice in the past, the AB held that 'panels and the AB are not bound to favour the most expedient approach. . . in a dispute'.[82] If the AB only assumed '*arguendo* that China can invoke Article XX(a) [it] could be at odds with the objective of promoting security and predictability through dispute settlement, . . ., in particular because such an approach risks creating uncertainty with respect to China's implementation obligations'.[83] The AB read the above mentioned phrase 'without prejudice to China's right to regulate

[80]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, para. 7.759.

[81]Panel *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/R, para. 7.790, 7.873 and 7.911.

[82]AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 213.

[83]AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 215.

trade in a manner consistent with the WTO Agreement' to refer to the WTO Agreement as a whole, including its Annexes.[84] It followed that this would grant China rights which the covered agreements affirmatively recognise accruing to members and also the relevant exceptions. The AB interpreted China's obligation concerning trading rights in its protocol of accession and the obligations imposed on all WTO Members by the WTO agreements in respect to trade in goods to be 'closely intertwined'.[85] It found that the measures that China sought to defend had an objective link to China's regulation of trade in the relevant products and, thus, China would be allowed to invoke a justification according to Article XX of the GATT 1994.[86] A successful justification would have, however, only been possible if China had demonstrated that all the requirements of Article XX lit. a of the GATT 1994 had been met. This was not the case since the measures were held not to be necessary.

The AB clarified how the necessity according to Article XX of the GATT 1994 should be assessed. Referring to its rulings in *US Gambling* and *BRA retreaded tyres*, the AB demands a 'sequential process of weighing and balancing a series of factors' involved.[87] The process of weighing 'begins with an assessment of the relative importance of the interests or values furthered by the challenged measure'. Then, other factors have to be balanced which would in most cases include '(i) the contribution of the measure to the realization of the ends pursued by it; (ii) the restrictive effect of the measures on international commerce' and (iii) possible additional factors. After this process of weighing and balancing, 'a comparison of the challenged measure and possible alternatives should be undertaken'.[88] The AB clarified that this alternative measure could impose additional financial or administrative burdens on the member applying the measure. The relevant question in that regard would be whether the member that is restricting trade can 'reasonably be expected to employ an alternative measure, consistent (or less inconsistent) with the covered agreements'.[89] This alternative measure might involve some change or administrative cost and it was decided that a member 'cannot demonstrate that no reasonably available alternative exists merely by showing that no cheaper alternative exists'. Rather, the respondent 'must establish that the alternative measure

[84] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, paras. 222–223.

[85] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 226.

[86] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 233.

[87] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 242.

[88] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 240.

[89] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 318.

would impose an undue burden on it, and must support such an assertion with sufficient evidence'.[90]

Arguably, a word of caution on the AB's findings on whether or not Article XX of the GATT 1994 applies to the Chinese protocol of accession is necessary. The AB neither found that Article XX of the GATT 1994 would be applicable to all obligations stemming from any accession protocol of any given member nor did it rule that the defence was available for duties contained in other Agreements than the GATT 1994. The ruling is based on the interpretation of the concrete stipulation on trading rights in the context of the Chinese protocol of accession and an objective link between the restricting measure at issue and the regulation of trade in goods was identified. Future panels will have to carefully assess along these lines before deciding whether a measure which restricts an obligation outside the GATT 1994 can be justified by invoking Article XX of the GATT 1994.

Before dealing with the question of a possible defence according to Article XX of the GATT 1994, the AB had to decide whether the measures concerning films for theatrical release were covered by China's trading rights. Only one importer, which is a wholly state owned enterprise, is allowed to import films into China.[91] China appealed the findings of the panel because it was of the view that China's trading rights commitments were not applicable to the Chinese measures pertaining to films for theatrical release. China argued that the measures on films for theatrical release did not regulate the importation of goods but rather regulated the *content* of the films and the *services* associated with the importation of such content.[92] China provided various reasons why the stipulation on films for theatrical release should not be regarded as dealing with trade in *goods*. According to China, the consequence would have been that the trading right commitments would not apply. The AB, however, confirmed prior jurisprudence on a possible parallel application of GATT and GATS provisions to a member's measure, i.e. that 'the same measure can be subject to obligations affecting trade in goods and obligations affecting trade in services'.[93] The AB upheld the panel's finding that the regulation had to be interpreted as determining 'who may engage in importing of hard-copy cinematographic films and, therefore, goods' as well.[94] Thus, China could not escape its commitments regarding trade in these goods.

The AB also agreed with the panel's interpretation that 'sound recording distribution services' in China's GATS schedule include the 'distribution of sound

[90]AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 327.

[91]AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 175..

[92]AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 169.

[93]AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 194.

[94]AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 198.

recordings in non-physical form, notably through electronic means'.[95] The AB had to interpret the phrase 'sound recording distribution services' in order to find out whether or not the commercially meaningful category of music downloads would also fall under this definition in China's schedule.

When determining the ordinary meaning of a treaty term according to Article 31 of the Vienna Convention, a panel or the AB should apply a 'holistic exercise' which 'should not be mechanically subdivided into rigid components'.[96] When assessing the relevant context for the interpretation of the relevant phrase, the AB also looked at other members' schedules but cautioned that the 'use of other Members' Schedules as context must be tempered by the recognition that each schedule has its own intrinsic logic' which might be different from the schedule at hand.[97] Interestingly, and systemically important for the interpretation of GATS schedules in general, the AB found the term 'sound recording and distribution' was 'sufficiently generic'-with the effect that what the term applies to 'may change over time'.[98] China had argued that the term could only have the meaning that it had at the time China's GATS schedule was concluded. However, the AB chose a more flexible approach and held that for these generic terms a dynamic interpretation has to be made since otherwise predictability, security and clarity of GATS specific commitments would be undermined.[99]

Panel *Columbia – Indicative Prices and Restrictions on Ports of Entry* (DS 366)

Facts of the Case

Panama complained about Colombia's import restrictions on textiles, apparels and shoes. As the title of the case indicates, the customs measures in question included the mandatory use of indicative prices with respect to certain imports originating in all countries except those with which Columbia had signed a free trade agreement. In these cases the customs authorities could calculate duties by using a fictional, indicative price instead of the declared value if the declared free on board

[95] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 338.

[96] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 348; on the application of Article 32 of the Vienna Convention cf. para. 403.

[97] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 382.

[98] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 396.

[99] AB *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, para. 397.

transaction value was lower than the indicative price. Additionally, the goods were generally only allowed to enter Columbia via Bogotá airport or, in the case of carriage of goods by sea, via Barranquilla seaport. The importer also had to undergo a certain customs procedure. The reason for these restrictions was reports of ongoing and significant problems with underinvoicing, smuggling and money-laundering.[100]

Important Aspects of the Findings

The case is the first one which interprets the WTO Customs Valuation Agreement. The panel defined customs valuation as 'the process of determining the monetary worth or price of imported goods for the purpose of levying customs duties'.[101] Article 1 of the Customs Valuation Agreement determines that principally the transaction value of the import is the determining factor for assessing the import duty. The panel found that the method of using indicative prices does not reflect any of the methodologies set out in the provisions of the Customs Valuation Agreement. The panel emphasised the sequential nature of the various methodologies laid down in Articles 1, 2, 3, 5 and 6 of the Agreement, i.e. a customs authority can only proceed from one of the prescribed methods of the Customs Valuation Agreement to the next if the former cannot be used. [102] Consequentially, Columbia's practice was found to violate the Agreement.

The decision was also the first one to touch upon the meaning of Article V of the GATT 1994. It clarified that Article V:1 of the GATT 1994 defines when goods can be qualified as being in transit across the territory of a member.[103] It concluded that the freedom of transit according to 'Article V:2, first sentence requires extending unrestricted access via the most convenient routes for the passage of goods in international transit whether or not the goods have been trans-shipped, warehoused, break-bulked, or have changed modes of transport. Accordingly, goods in international transit must be allowed entry whenever destined for the territory of a third country'. This does not mean that the members have to guarantee transport on all routes in its territory but the ones 'most convenient'.[104] The Columbian measure was therefore also found to be in breach of several obligations contained in Article V of the GATT 1994.

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[100]Panel *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R, paras. 2.1–2.15.

[101]Panel *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R, para. 7.83.

[102]Panel *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R, paras. 7.136–7.143.

[103]Panel *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R, para. 7.388 and para. 7.395, fn. 680.

[104]Panel *Columbia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R, para. 7.401

When dealing with the ports of entry measure, the panel also found that the Columbian measure was inconsistent with Article XI:1 of the GATT. In its assessment of Article XI:1 of the GATT 1994, the panel found that the measure was a restriction on importation since it had a limiting effect on importation by negatively affecting the competitive opportunities available to the products in question.[105]

State of Play

The parties did not appeal the report. However, according to Article 21.3 lit. c of the DSU they asked the arbitrator to determine the rpt for the implementation of the decision. Columbia was granted eight months and 15 days to implement the decision.[106]

AB *US – Laws Regulations and Methodology for Calculating Dumping Margins („Zeroing") (Art. 21.5 DSU)* (DS 294)

Facts of the Case

The case was yet another zeroing case. Zeroing is a methodology applied by the US authorities when calculating the margins of dumping for the antidumping duties. The US authorities determine whether dumping occurred. Based on the outcome of these investigations the US authorities issue an Antidumping Duty Order which allows for the collection of cash deposits at the time of importation of a good. In a subsequent review, the authorities retrospectively assess the liabilities on specific entries of individual importers for a certain period of time. Once a year interested parties can request an administrative review to determine their final amounts, which also serve as a basis for future entries. When assessing the importers' final liability, the US applied zeroing.[107] During the investigations some of the individual products may show a positive margin of dumping which means that they have been dumped. Other products may show negative margins of dumping, i.e. they are not dumped. When making an assessment for the whole group of products under consideration, some of the positive and negative margins would cancel each other out. Zeroing, however, means that any negative margin is valued as zero, which means in return that only the positive margins are taken into account for

[105]Panel *Colombia – Indicative Prices and Restrictions on Ports of Entry*, WT/DS366/R, paras 7.256, 7.274–7.275.

[106]WT/DS366/13, para. 111.

[107]AB *US - Laws Regulations and Methodology for Calculating Dumping Margins („Zeroing") (Art. 21.5 DSU)*, WT/DS294/AB/RW, paras. 2.4–2.5.

the assessment of the margin of dumping. The result will thus always be a higher margin.[108]

The EU claimed that the US failed to implement the original AB report which prohibited the use of zeroing.

Important Aspects of the Findings

A procedural issue the EU brought up concerned the composition of a panel by the WTO Director-General according to Article 8.7 of the DSU. The EU claimed that the Director-General improperly composed the panel under Articles 8.3 and 21.5 of the DSU. Notably and interestingly, without further explanation, the AB just held that the Director-General has discretion in composing panels and that this discretion 'was properly exercised in this case'.[109]

The AB made some findings in regard to compliance panels according to Article 21.5 DSU that increase the protection of the winning party and make it more difficult for the party which has to comply with the ruling since it cannot so easily escape compliance through invoking formal arguments.

One question was whether a measure that had been taken before the adoption of the DSB ruling could be regarded as a measure taken to comply within the meaning of Article 21.5 DSU. This concept is interesting since the rulings of the DSB create obligations with prospective effects for the future.[110] The AB held that measures with a 'particularly close relationship with the declared measures taken to comply' may also fall within the panel proceedings, even though these measures, strictly speaking, could not have been taken to comply with a that time non-existent ruling. Since the timing of a measure is not determinative for the nexus test of the AB, a compliance panel may review events predating the adoption of the DSB ruling.[111]

The AB furthermore followed the EU's petition that the US were obliged to cease zeroing 'not only with respect to imports entered after the end of the reasonable period of time, but also in the context of decisions involving the calculation of dumping margins made after the end of the reasonable period of time with respect to imports entered before that date'.[112]

It is also procedurally interesting that the compliance panel was seen not to preclude the rise of new claims against measures 'that incorporated unchanged

[108]Goode, *Dictionary of Trade Terms*, (5th ed.) 2007, p. 491.

[109]AB *US - Laws Regulations and Methodology for Calculating Dumping Margins („Zeroing") (Art. 21.5 DSU)*, WT/DS294/AB/RW, para. 172.

[110]AB *US - Laws Regulations and Methodology for Calculating Dumping Margins („Zeroing") (Art. 21.5 DSU)*, WT/DS294/AB/RW, fn. 406.

[111]AB *US - Laws Regulations and Methodology for Calculating Dumping Margins („Zeroing") (Art. 21.5 DSU)*, WT/DS294/AB/RW, paras. 223–224.

[112]AB *US - Laws Regulations and Methodology for Calculating Dumping Margins („Zeroing") (Art. 21.5 DSU)*, WT/DS294/AB/RW, para. 311.

aspects of original measures that could have been made, but were not made, in the original proceedings'. This is, however, only possible if 'these new claims relate to a measure taken to comply and do not re-argue claims that were decided in the original proceedings'.[113]

AB *US – Continued Existence and Application of Zeroing Methodology* (DS 350)

Facts of the Case

The case was the second zeroing case that the EU brought against the US. Unlike the previously described case, the AB did not deal with compliance issues but dealt with the question whether certain antidumping investigations complied with the AD Agreement.

Important Aspects of the Findings

The AB confirmed again that the methodology of zeroing violates certain provisions of the AD Agreement.[114] The AB dealt with Article 17.6 (ii) of the AD Agreement which says that if there are two permissible interpretations of a relevant provision of the AD Agreement, then both measures have to be found to be in conformity with the agreement. The US claimed that zeroing in periodic reviews rested on such a permissible interpretation.[115] The AB explains how the customary rules of interpretation of public international law as codified in Articles 31 and 32 of the Vienna Convention are to be applied.[116] It arrived at the conclusion that the permission of zeroing cannot be reconciled with the customary rules of interpretation since otherwise mutually contradictory results (zeroing permissible versus prohibited) would be allowed. Consequentially, the application of Article 17.6 (ii) of the AD Agreement was denied.[117]

Special attention should be paid to the concurring opinion of one member of the AB. Concurring opinions only seldom occur. However, this concurring opinion is

[113]AB *US - Laws Regulations and Methodology for Calculating Dumping Margins („Zeroing") (Art. 21.5 DSU)*, WT/DS294/AB/RW, para. 427.

[114]AB *US – Continued Existence and Application of Zeroing Methodology, WT/DS350/AB/R*, paras. 276–303.

[115]AB *US – Continued Existence and Application of Zeroing Methodology, WT/DS350/AB/R*, para. 265.

[116]AB *US – Continued Existence and Application of Zeroing Methodology, WT/DS350/AB/R*, paras. 267–268.

[117]AB *US – Continued Existence and Application of Zeroing Methodology, WT/DS350/AB/R*, paras. 269–275.

not only interesting because it rarely occurs, but also because of its content. Very clearly, one member of the AB is anonymously calling for an end to the long standing debate on whether or not the zeroing methodology is permissible. The Member points out that the AB 'has spoken definitively' on the question of zeroing and that the membership can 'rely upon these outcomes'. Thus, it would be more 'important for the system of dispute resolution to have a definite outcome, than further to pick over the entrails of battles past'. That sounds like someone wanted to send a very clear and unambiguous message on the question of zeroing: End of discussion, please. However, this did not prevent new cases on zeroing arising.[118]

Panel *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)* (DS 322)

Facts of the Case

In 2007 Japan had won a zeroing case against the US when the AB had found that certain anti-dumping AD measures which relied on the zeroing practices by the US authorities were inconsistent with the AD Agreement. In the related compliance procedure according to Article 21.5 of the DSU Japan claimed that the US still failed to comply with the given recommendations.

Important Aspects of the Findings

The panel found that the US were not complying with the recommendations adopted by the DSB.

The US argued that certain subsequent anti-dumping AD reviews fell outside the panel's jurisdiction since the original reviews in question had been withdrawn and thus compliance accomplished. In the view of the US, the original anti-dumping AD reviews were superseded by subsequent reviews when the cash deposit rate from one review was replaced by the cash deposit rate from the next review. The original measures should therefore be regarded as eliminated.[119]

The panel touched upon an important underlying aspect of Article 21.5 proceedings which lies in the very nature of compliance proceedings. Members could try to escape compliance by putting a new label on the original measure which nevertheless has the same defect. The panel thus reiterated former AB jurisprudence and

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[118]Cf., e.g., *US – Use of Zeroing in Anti-Dumping Measures Involving Products from Korea* (DS 402).

[119]Panel *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/RW, paras. 7.32–7.34.

emphasised that 'there are some limits on the claims that can be raised in Article 21.5 proceedings' on the one hand but that 'these limits should not allow circumvention by members by allowing them to comply through one measure, while, at the same time, negating compliance through another'.[120] Thus, the panel again strengthened the rights of the winning member by trying to bar the losing member from just complying in form but not in substance. It would be unfair if a sole relabelling of measures would do the trick of bringing a member into compliance.

The question when a measure can be regarded as 'taken to comply' within the meaning of Article 21.5 of the DSU was answered by applying a nexus test: it was considered to have been taken to comply if it is 'sufficiently closely connected to the original dispute that gave rise to those recommendations and rulings'.[121] The concrete measures in question were found to 'form part of a continuum' whose purpose was the ongoing assessment of the antidumping duties in question.[122] The panel ruled that the elimination of existing cash deposit rates should not be reviewed separately from the superseding administrative review[123] and clarified that zeroing was continued.[124]

The US further argued that future measures which are not in existence at the time of a panel request cannot be subject to the dispute settlement. The panel, however, was of the view that it was possible to challenge a measure that was not existent at the time of the panel request.[125] The panel furthermore clarified that a 'measure must have been brought into conformity irrespective of the date of entry of the imports covered by the measure'.[126] This general rule applies also to the retrospective antidumping system of the US.

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[120]Panel *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/RW, para. 7.57.

[121]Panel *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/RW, para. 7.62.

[122]Panel *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/RW, para. 7.65.

[123]Panel *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/RW, para. 7.71.

[124]Panel *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/RW, para. 7.75.

[125]Panel *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/RW, paras. 7.115–7.116.

[126]Panel *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/RW, para. 7.148.

AB *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)* (DS 322)

On appeal, not a single claim of the US was successful. The AB reiterated its interpretation, which should be pretty straightforward anyway, i.e. that the parties have to comply with the recommendations by the end of the time of the rpt at the latest.[127] It also confirmed its interpretation in *US Zeroing (Article 21.5 – EC)* that WTO inconsistencies must cease by the end of the rpt irrespective of the date on which the imports entered the territory of the implementing member.[128] 'In other words, the WTO inconsistent conduct must cease completely, even if it is related to imports that entered the implementing member's territory before the rpt expired'.[129] Like the panel the AB decided that the date of entry is not relevant parameter for determining compliance.[130] The AB also made it clear that the retrospective anti-dumping system would thereby not be treated less favourably than prospective anti-dumping systems of other countries.[131] Furthermore, the US tried to justify the delayed implementation with reference to pending domestic judicial proceedings since these proceedings would be controlled by the independent judiciary and not by the administration. Recalling from *US Shrimp* the AB made clear that each WTO member bears responsibility for all 'acts of its departments of government, including its judiciary',[132] which meant that the excuse was not accepted.

Arbitration *US – Subsidies on Upland Cotton (22.6 DSU)* (DS267)

Facts of the Case

In the so-called cotton case the AB found that certain US payments constituted prohibited subsidies which are per se prohibited and held that certain actionable subsidies were inconsistent with the SCM Agreement because they fulfilled

[127] AB *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/AB/RW, paras. 157 and 167.

[128] AB *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/AB/RW, para. 160.

[129] AB *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/AB/RW, para. 161.

[130] AB *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/AB/RW, para. 163.

[131] AB *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/AB/RW, para. 166.

[132] AB *US – Measures Relating to Zeroing and Sunset Reviews (Art. 21.5)*, WT/DS322/AB/RW, para. 182.

additional criteria laid out in the SCM Agreement. After having concluded the compliance stage, Brazil asked the arbitrator to determine the level of countermeasures to be taken against the US.

Important Aspects of the Findings

The arbitrator issued two rulings, one in regard to the prohibited subsidies[133] and one on actionable subsidies.[134] The decision of the arbitrator looks at the level of retaliation measures and decided if Brazil was allowed to cross-retaliate in the areas of TRIPS and services.

When determining the level of retaliation available to Brazil, the arbitrator had to decide whether the global impact of the actionable subsidies paid by the US had to be taken into account. The arbitrator held that the entire impact on Brazil of the price suppression resulting from the granting of the subsidies on the world cotton market was at issue.[135] According to the decision by the arbitrator the American subsidies resulted in world cotton prices 9.38% higher than they would have been without them. Since Brazil accounts for roughly 5% of the world production, Brazil was awarded $147 m of sanctions.[136]

In regard to the prohibited subsidies, the panel chose a flexible approach. It found that the amount of countermeasures would be variable on an annual basis, depending on the use of the American subsidies in a given fiscal year. Based on the 2006 figures, this would have been another $147 m.[137]

The panel, in contrast, denied a retrospective countermeasure for a past period of non-compliance after the rpt ceased but which was no longer existent at the time of the decision of the arbitrator.[138]

Article 22.3 of the DSU stipulates that retaliatory measures have generally to be taken with respect to the same sector, i.e. within the sector that the violation occurred. 'If a party considers that it is not practicable or effective' to retaliate with respect to the same sector, Article 22.3 lit. b of the DSU allows retaliation in other sectors of the same agreement. If that is not practicable or effective, Article 22.3 lit.

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[133] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)*, WT/DS267/ARB/1.

[134] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2.

[135] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2, paras 4.92, 4.107.

[136] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2, paras 4.193–4.195, based on 2005 figures.

[137] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)*, WT/DS267/ARB/1, paras. 4.278–4.279.

[138] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)*, WT/DS267/ARB/1, paras. 3.49, 3.50 and 3.62.

c of the DSU opens the way to seek retaliatory measures under another agreement, the so called right to cross-retaliate. Thus, if a member, e.g. is violated by a breach of the GATT 1994 it will primarily seek the suspension of concessions in this area before retaliating with respect to TRIPS rights and obligations. Brazil argued that it was not practicable or effective to take retaliatory measures only with regard to goods but asked for the authorisation of retaliatory measures with respect to the GATS and TRIPS. In determining what practicality meant, the arbitrator decided that this related to the question of 'its actual availability and feasibility'.[139] The interpretation of effectiveness was taken in the light of the party seeking the granting of retaliatory measures: 'In a situation, where the complaining party would cause itself disproportionate harm, such that it would in fact be unable to use the authorization, there would be a basis for concluding that such suspension would not be effective'.[140] Consequentially, the arbitrator looked at the profile of imports of goods from the US to Brazil and decided that Brazil could not be expected to retaliate in relation to imports of capital, intermediate and other essential inputs into Brazil's economy since Brazil would hurt itself with these measures.[141] Even in regard to consumer goods (food, medical products and arms) that are imported from the US, many products were excluded as impractical for taking countermeasures: Only if the US share of imports was below 20% of all imported goods of this category were the goods deemed to be available for sanctions; if the share was above this 20% threshold, the product group was not taken into account because Brazil was assumed to harm its economy disproportionately by applying sanctions against these goods.[142] Based on these assumptions, the arbitrator held that it was still practicable and effective for Brazil to retaliate with regard to goods up to a threshold of imports of $410 m. In other words, there was no ground for cross-retaliation under that threshold. However, in view of future developments, the arbitrator again took a flexible approach: 'In the event that the level of countermeasures that Brazil would be entitled to in a given year should increase to a level that would exceed this threshold, *updated for the same year*' it

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[139] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)*, WT/DS267/ARB/1, para. 5.73; *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2, para. 5.73.

[140] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)*, WT/DS267/ARB/1, para. 5.79; *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2, para. 5.79.

[141] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)*, WT/DS267/ARB/1, para. 5.153; *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2, para. 5.153.

[142] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)*, WT/DS267/ARB/1, para. 5.181; *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2, para. 5.181.

would no longer be practicable or effective and Brazil could cross-retaliate in the TRIPS and GATS area.[143] The arbitrator also found that the second precondition of Article 22.3 lit. c of the DSU was fulfilled as well, i.e. that the circumstances were serious enough.[144]

Under this flexible approach, Brazil claimed that it could take sanctions in 2010 up to a value of $800 m, of which $340 m would be cross-retaliation.[145]

Conclusion

Clarification of the provisions and implications of WTO law through the panel and especially AB jurisprudence are and will be of paramount importance to the understanding of WTO law. This effect will be even stronger after the AB decision on binding guidance of its jurisprudence. Future decisions will therefore continue to clarify concepts and definitions of WTO law which are currently not yet settled.

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[143] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)*, WT/DS267/ARB/1, para. 5.201; *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2, para. 5.201.

[144] *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)*, WT/DS267/ARB/1, para. 5.217; *US – Subsidies on Upland Cotton (Recourse to Arbitration by the US under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement)*, WT/DS267/ARB/2, para. 5.217.

[145] Intellectual Property Watch, 7 September 2009, http://www.ip-watch.org/weblog/2009/09/07/wto-ruling-on-brazil-cotton-opens-door-to-cross-retaliation-against-ip-rights/.

Part IV
Book Reviews

Rudolf Dolzer, Christoph Schreuer, Principles of International Investment Law

Oxford University Press, Oxford, 2008, ISBN 978-0-19-921176-0

Internationales Investitionsschutzrecht

Verlag C.H. Beck; München, 2008, ISBN 978-3-406585-7

Marc Bungenberg

International investment law has developed into one of the fundamental pillars of international economic law in the past decade, with an ever-increasing significance. Rudolf Dolzer and Christoph Schreuer as two leading scholars in international investment law show in their concisely written study especially the dynamic development and the heterogeneity of the reasoning of arbitral awards. The authors refer to and cite specific passages of awards as well as of international investment agreements throughout the entire volume. Thus, the study includes almost an "international investment law in cases", the practice of international investment law being embedded in the broader international law context.

The reason for the rising importance of international investment law – as Dolzer and Schreuer point out in the introductory part on the "Nature, Evolution, and Context of International Investment Law" of their clearly structured, ten-chapter book – is especially the rules-oriented approach of international economic politics that led to the conclusion of approximately 2,700 bilateral investment treaties (BITs) by the end of 2009 and well over 320 investment treaty disputes – the latter number only regarding pending or concluded International Centre for the Settlement of Investment Disputes (ICSID) disputes. In only a few pages the authors explain more than clearly the evolution along with the necessary economic background. References especially to primary sources such as the Abs–Shawcross Draft are given extensively.

The organization of the book then follows a logical order. Chapter 2 deals briefly with the interpretation and application of investment treaties providing the background for the following chapters. Chapter 3 on "Investors" and "Investments" elaborates on the basic elements for the application of investment law as they are

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_21, © Springer-Verlag Berlin Heidelberg 2011

used in practice. Chapter 4 on "Investment Contracts" is brief as well, but treats all the relevant points of this field of investment law. Chapter 5 is on the admission and establishment of investments. Just as in the area of trade in services, the nation states have been reluctant up to now to a large degree to liberalize market access. Dolzer and Schreuer point out the different approaches the USA, Canada and Japan, on the one hand, and the "European countries", on the other hand, follow. This will probably gain even more attention when an EU model BIT is hopefully discussed soon. Special attention is given to the now more or less well-established principle of international law that investors are obliged to conduct their business in a prescribed manner, especially with the host state law and international public policy.

Although with the rising number of BITs investment contracts between the investor and the host state have increasingly lost their significance, the general principles for expropriation as well as the standards of protection as they are laid down in almost all international investment agreements are of increasing importance. Regarding the total length of the book, the discussion of these topics in Chaps. 6 and 7 is one of the two focal points. The authors emphasize the growing discussion on indirect expropriation and protection standards. Therefore, they especially analyse the case law the interpretation and the developing doctrine of standards of protection clauses is based on. Dolzer and Schreuer describe the different notions of indirect expropriation, their connection with national regulation because of public policy reasons as well as changing standards of compensation. Particular consideration is given to broad treaty rules on standards of protection, the understanding of which has mainly been shaped by their interpretation and application by the practice of international tribunals as well. This evaluation of the developing principles and standards of "fair and equitable treatment", "full protection and security", "national treatment", "most-Favoured-nation treatment" etc. gives an impressive idea of how international investment law might influence domestic regulation.

Chapter 8 concentrates on "State Responsibility and Attribution", a topic that has only been partly discussed in the general context of public international law up to now and that in the area of international investment law will soon attract a lot more attention, especially with the EU as a new actor in this field of law. A topic also of major practical relevance is the insurance of foreign investments, either in the home state of the investor by nation governments or with international institutions such as the Multilateral Investment Guarantee Agency (MIGA). This is what Chap. 9 on "Political Risk Insurances" deals with. Finally, in Chap. 10, the book introduces the dispute settlement mechanisms for enforcing standards and principles of protection, outlining the operation of state versus state and investor versus state disputes, the latter being at the same time the second focal point of this volume. Dolzer and Schreuer analyse in depth the dispute settlement mechanisms at work with a special focus on the ICSID, taking into account procedural issues as well, for example problems resulting from a too broad application of the most-avored-nation clause. The very useful annex contains the most relevant texts for working in investment law: it includes the model BITs of the UK, France, Germany and China as well as the Energy Charter Treaty, NAFTA Chapter XI and the ICSID Convention.

As a conclusion, *Principles of International Investment Law* by Rudolf Dolzer and Christoph Schreuer offers far more than just an introduction to international investment law, as one would expect of less than 300 pages of text. It is probably the most comprehensive and in-depth monograph of most aspects of the topic of international investment law there is today. It is not only the number 1 textbook, but it is also a necessary tool for everybody working in this field.

Jörn Griebel from the International Investment Law Center Cologne (IICLL) of Cologne University presents the first introductory textbook on the international investment protection topic in the German language. His work is divided into seven chapters. In a very readable introductory first chapter, in which Griebel positions investment law in the overall structure of international law, he identifies the enforcement of standards of protection as they are especially guaranteed in international investment agreements as the core of international investment law as it stands today. These ideas therefore "structure" his work with two main parts on the protection of investors via investment protection agreements in Chap. 4 on more than 70 pages and Chap. 6 on investment disputes before international dispute settlement institutions. The reasons for the importance of special treaty standards and treaty-based enforcement structures are – as Griebel sets out in Chap. 2 – the shortfalls of general public international law with (vague) protection standards without a special enforcement mechanism. Griebel concludes his 150 pages of text with an overall assessment of investment law and an outlook on this dynamic discipline.

Not only is this the first textbook on the topic in the German language, it is at the same time one of the most concise studies on investment law; Griebel shows the clear advantage of a textbook written by a single author. The author has produced a great work that will hopefully be regularly updated and soon find its way into an English version as well.

Daniel Wüger and Thomas Cottier, Genetic Engineering and the World Trade System

Hans-Georg Dederer

I.

1. Modern biotechnology and WTO law continue to be welded together in an uncomfortable relationship. The *Biotech Products* case is ample proof. The respective WTO panel's report was adopted by the Dispute Settlement Body (DSB) in 2006,[1] but it has not really calmed down the controversy. In particular, the EU is still stunningly slow in approving new genetically modified organisms (GMOs) and in lifting provisional safeguard measures adopted by some EU member states prohibiting, e.g. the cultivation of genetically modified (GM) maize.

More dark clouds seem to be looming on the horizon though. The EU intends to let member states regulate the cultivation of GMOs on their own.[2] The result might be that some member states ban the cultivation of GMOs entirely or in parts of their country, whereas others allow GMOs to be cultivated only in specially designated zones or under severe regimes of good agricultural practice standards. And it is more than mere rumour that the EU is considering including socio-economic considerations into its decision-making process concerning applications for marketing approval of new GMOs. Transatlantic trading partners will certainly try to find the fly in the ointment, claiming incompatibility of the EU's revised regulatory framework with WTO law.

2. Besides these considerations prompted by the EU's current legislative activities, there is also a genuine jurisprudential interest in exploring the relationship between modern biotechnology and WTO law. On the international level, products of modern biotechnology are specifically regulated in the Cartagena Protocol on Biosafety (CPB), which is a multilateral environmental agreement (MEA).

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[1] WTO Panel, *European Communities – Approval and Marketing of Biotech Products*, WT/DS291/R, WT/DS292/R, WT/DS293/R.

[2] Press Release IP/10/222, 2 March 2010: Commission announces upcoming proposal on choice for Member States to cultivate or not GMO's and approves 5 decisions on GMO's.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_22, © Springer-Verlag Berlin Heidelberg 2011

Thus, the quest for the bearing of WTO law on modern biotechnology leads into the arena of trade and the environment and, more specifically, into the unsettled debate on the relationship between MEAs and WTO law. Modern biotechnology touches, however, on many more legal hotpots: Is the WTO precaution-averse? Is WTO law compatible with human rights obligations (e.g. to ensure the right to health or to respect indigenous peoples' rights)? We could easily extend the list of questions. Luckily, the most intriguing problems have been addressed in Daniel Wüger and Thomas Cottier's volume *Genetic Engineering and the World Trade System.*

3. It follows from the foregoing that Daniel Wüger and Thomas Cottier have chosen a most exciting subject. The book is subdivided into five parts, starting with "Introduction and systemic issues" (Part I). The following parts cover current and contentiously discussed topics, that is to say "Intellectual property and gene technology" (Part II), "Food security, trade and agricultural production with genetically modified organisms" (Part III), "Food safety, international trade and biotechnology" (Part IV) and, finally, "Medical research, cloning and international trade" (Part V).

Any reader interested in WTO law and modern biotechnology regulation will be curious about the theses presented by the 13 authors. And if we are allowed to anticipate our general impression, we dare to say that the reader is overwhelmed with most valuable information, intriguing lines of argument, and provocative standpoints. Nevertheless, as we will see, some critical remarks are inevitable.

II.

1. It is Daniel Wüger who raises the curtain presenting "The many faces of modern biotechnology" (pp. 3 et seq.). He reveals that the book collects contributions prepared by speakers participating in the World Trade Forum 2005 in Berne, Switzerland (cf. p. 4). Wüger assures us that the contributions were "subsequently revised" (p. 4). Considering the actual year of publication (2008), one might expect that the contributors had ample time to take into account later factual and legal developments. It is, therefore, somewhat annoying that the WTO Panel report on the *Biotech Products* case, which was circulated in September 2006 (and adopted by the DSB in November 2006), received almost no attention at all, even not by contributors (with the exception of Simonetta Zarrelli) whose subject should have given reason to analyse the panel report thoroughly.

Apart from that, Daniel Wüger gives a very informative and concise account of modern biotechnology's impact on sustainable development (pp. 5–14) and of the regulatory framework governing modern biotechnology (pp. 14–16). Regrettably, the problem of socio-economic considerations is touched upon too briefly (cf. p. 12). In fact, under Article 26(1) of the CPB states, "in reaching a decision on import under this Protocol or under its domestic measures implementing the Protocol, may take into account, consistent with their international obligations, socio-economic considerations arising from the impact of living modified organisms on the conservation and sustainable use of biological diversity, especially with

regard to the value of biological diversity to indigenous and local communities". A number of questions are attached to this provision. What are socio-economic considerations? Who is in charge of identifying the relevant socio-economic considerations in a given case? What are the parameters for the adequate rating and fair balancing of socio-economic concerns? May socio-economic considerations override a scientific risk assessment? Is the taking into account of socio-economic considerations "consistent with . . . international obligations", e.g. with obligations resulting from WTO law? What is the decisive normative framework if the import of GMOs is denied on the basis of socio-economic considerations: GATT, the SPS Agreement or the TBT Agreement? Answers to these questions would be helpful in the forthcoming European debate on the issue of incorporating socio-economic considerations into the process of GMO marketing approval.

2. Thomas Cottier takes up a most sensitive issue, namely, the relationship between international trade law and human rights against the background of modern biotechnology. Cottier's article "Genetic engineering, trade and human rights" (pp. 17 et seq.) provides us, first of all, with a comprehensive spectrum of legal problems surrounding the bearing of WTO law on the transboundary movement of GMOs (pp. 19–20). The author continues to give a full and detailed account of "underlying issues", i.e. of those political, social, economic and ethical problems which form the arena within which the regulation of genetic engineering sprouts (pp. 21–22).

After having mentioned both human rights law and WTO law relevant in the field of modern biotechnology (pp. 24–26), the author justly accentuates the ambiguity of human rights regarding genetic engineering (pp. 29–31). Genetic engineering may foster human rights just as genetic engineering may compromise human rights. In any case, human rights law does not directly govern international trade in GMOs (p. 32). It is rather WTO law which sets the rules for the importation and exportation of GMOs. However, human rights may be conveyed into WTO law via portals (cf. pp. 35–47). Taking into account Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT), Cottier correctly points out that in the case of a dispute between WTO members, human rights may be only considered "as a matter of law" if the parties concerned are bound by the respective human rights (p. 34). Under GATT and GATS, it is, in particular, the general exceptions clauses (Article XX GATT, Article XIV GATS) which function as "portals" allowing human rights standards to be taken into consideration (pp. 35–38). In contrast, under the TRIPS Agreement, the author suggests that human rights should be taken into account in the interpretation of intellectual property rights (IPRs), i.e. the scope and content of IPRs "should be construed so as to be consistent with these rights" (p. 38). Cottier, of course, does not lose sight of Article 31(f) of the TRIPS Agreement, which is also a kind of exceptions clause and which gave reason for the adoption of a waiver exempting WTO members from certain obligations under Article 31(f) and (h) of the TRIPS Agreement (cf. p. 41). Accordingly, WTO members may grant a compulsory licence for the purpose of exporting pharmaceuticals into countries which lack the capacities necessary to produce the respective pharmaceuticals on their own.

Cottier's final section is dedicated to sketching elements of future trade regulations for biotechnology (pp. 47–54). According to the author, such biotechnology-related rules should either be incorporated into existing WTO agreements (by amending, e.g. GATT, the SPS Agreement and/or the TBT Agreement) or, alternatively, be laid down in a new treaty. All in all, Cottier's proposals merit careful attention. According to Cottier, the scientific risk assessment should be entrusted to international organizations (p. 48). The burden of proof that the GMO is safe should be borne by those who seek market access (p. 49). Risk management ought to be based on a scientific risk assessment. Owing to its essentially political nature, risk management should remain each WTO member's own responsibility (p. 49). In addition, risk management may provide the portal for human rights concerns. Unfortunately, Cottier does not really address the tension between scientific risk assessment and political risk management: Why should the applicant provide an extensive and expensive scientific risk assessment supporting the safety of his or her GMO product if the competent political authorities give more weight to other legitimate factors and deny marketing approval in the end? What are those other legitimate factors which may be taken into account when deciding on risk management measures? What are the parameters for a proper balancing of those other legitimate factors against the scientific risk assessment?

These questions are, in our opinion, closely related to the problems associated with a public morality clause (pp. 50–51). If "risk management is inherently a matter for decision by political [sic!] authorities" (p. 49), then decisions on risk management measures may legitimately be based also on "prevailing ethical or moral grounds" (p. 50). What has to be avoided is that public morality clauses open the floodgates to arbitrariness. Cottier's answer seems to be that "[h]uman rights standards offer a rational approach to the problem of ethical restrictions. They specify the concept of morality and seek to inject some objectivity . . . . They assist in avoiding economic protectionism put forth in the name of morality or religion" (p. 51). We tend to agree with Cottier, adding, however, the caveat that the rationality of his human rights approach depends on how strict WTO panels or the WTO's Appellate Body will control WTO members' measures allegedly based on the public morality clause.

Cottier's further proposals concern the enhanced protection of traditional knowledge within the framework of the TRIPS Agreement. In fact, "prior informed consent and the indication of source" as prerequisites for patentability may serve the combat against "biopiracy" (cf. p. 51). The author also calls for procedural human rights to be incorporated into treaties on modern biotechnology (p. 53) and for a coherent international regulatory framework as well as for adequate procedures for the cooperation between different international fora involved in the regulation of genetic engineering (pp. 53–54).

3. Constance Z. Wagner's article concerns "Gender dimensions of biotechnology policy and trade" (pp. 56 et seq.). With regard to modern biotechnology, gender studies are, the way we see it, a relatively new and innovative phenomenon.

Wagner identifies three areas in which gendered aspects of biotechnology policy and trade play a critical role: agriculture, traditional knowledge and health care

(pp. 58–66). Subsequently, the current international framework for gender mainstreaming is described in great detail on pages 66–73. The most ambitious approach with regard to mainstreaming a gender perspective in all areas of politics hitherto is the Beijing Declaration of 1995. Wagner concedes that the Beijing Declaration does "not address gender mainstreaming in biotechnology directly", but "refers to the three areas in which biotechnology may have gender-specific impacts", i.e. agriculture, traditional knowledge and health care (p. 69). More specifically, Wagner points to a gender mainstreaming strategy designed under the auspices of the UN Commission on Science and Technology for Development (UNCSTD) which virtually implements the Beijing Declaration in the fields of science and technology (p. 72). To strengthen UNCSTD's efforts, she advocates an "international agreement on gender within the field of science and technology" (p. 72) which, ideally, should be also applicable to gender mainstreaming in biotechnology policy and trade (p. 73). For a start, Wagner proposes a "type of gender mainstreaming programme" which could lay the foundations for a more comprehensive gender mainstreaming approach in modern biotechnology policy and trade (p. 74).

The clearly phrased and worth-reading article leaves some questions though. To accentuate the fundamental significance of women's normative equality with men, the author points to the Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW; pp. 56–57). However, despite the impressing figure of 186 state parties, one has to keep in mind that, in particular, the Islamic states made sweeping reservations to Article 2 of CEDAW. The universal impetus of CEDAW is, therefore, seriously compromised. Article 2 of CEDAW is of utmost importance for the practical effectiveness of CEDAW's guarantees. It obliges all parties "to pursue by all appropriate means and without delay a policy of eliminating discrimination against women" and, to this end, to undertake a series of legislative and other measures.

We dare to ask the offensive question, and we do apologize promptly, why the incorporation of a gender perspective into the debate on biotechnology policy and trade matters at all. The call for gender mainstreaming in biotechnology policy and trade seems to imply that biotechnology policy and trade tend to advantage men over women or to adulterate the situation of women compared with that of men. Of course, agrobiotechnology will have significant impacts on women because women play a critical role in agriculture worldwide (p. 59). However, agrobiotechnology actually impacts on anyone who is working in agriculture irrespective of his or her sex. Wagner also contends that the field of science and technology is recognized as touching all areas of women's lives (p. 69). Again, the same holds true for anyone else irrespective of his or her sex because science and technology affect society at large. The author argues furthermore that "[a]dverse health impacts of biotechnology ... may have exponential consequences when gender is taken into account". Wagner's rationale is, inter alia, women's "reproductive capacity, which makes them particularly vulnerable to health impacts" (p. 61). But is women's reproductive capacity really more vulnerable than men's?

Having made these heretical remarks, we would like to admit that, on the other hand, Wagner also made a convincing case defending her thesis that women

deserve special and more attention in biotechnology policy and trade. Indeed, if it is correct (and we assume it is) that it is primarily women who care for children, predominantly women will be affected if children fall ill because of biotechnology products (cf. p. 61). If it is true (and we find some truth in it) that agrobiotechnology may help overcome undernourishment, then women (and children) will benefit most because women (and children) suffer most from malnutrition (cf. p. 60). Most interestingly, European averseness to GMOs may first and foremost disadvantage women in other parts of the world because "they are the primary agricultural producers in many developing countries" (cf. pp. 62–63). For the same reason, GMO exports from developed countries to developing countries may exert unendurable pressure on women (cf. p. 63). Moreover, insofar as traditional knowledge "is often furthered and preserved primarily by women" (p. 64), both special protection of traditional knowledge against so-called biopiracy and access–benefit-sharing arrangements would inure to the benefit of women. Finally, if it is true (and we believe it to be) that women are "particularly vulnerable to increases in the price of drugs used to treat [HIV/AIDS]" (p. 66), one has to think about preferential access of women to such drugs (cf. p. 66).

4. The contribution by Geertrui Van Overwalle attends to "Biotechnology and patents" (pp. 77 et seq.). This very instructive article presents the multilayered regulatory system of biopatenting. The author examines on each level, i.e. on the global, European and national levels, more or less the same issues, namely, firstly, the patentability of biological material, in particular of microorganisms, plants and animals; secondly, the patentability of the human body, of human genes or gene sequences, respectively, and of stem cells; thirdly, the influence of ethical considerations on patentability of living, in particular human subject matter; fourthly, the safeguarding of human rights within the respective patent law framework; fifthly, intellectual property protection of traditional knowledge; and, sixthly, the obstructive effects of patents with regard to safeguarding of public health.

Modern biotechnology as well as biotechnology regulation are rather dynamic matters. This holds true especially with regard to biopatenting. It is, thus, comprehensible that the author could not take into account some of the more recent and most interesting scientific and legal developments. On page 86, e.g. Van Overwalle refers to the waiver adopted by the General Council in 2003 exempting WTO members from certain obligations set out in Article 31(f) and (h) of the TRIPS Agreement. She also mentions the General Council's decision of 2005 to formally incorporate the waiver into the TRIPS Agreement by inserting a new Article 31 *bis* and an annex. Up to the present day, however, these amendments to the TRIPS Agreement have not entered into force. Nevertheless, on the basis of the waiver of 2003, Canada was the first (and hitherto the only) country to submit a notification in 2007 according to which Canada had authorized Apotex "to make, construct and use, [certain] patented inventions ... solely for purposes directly related to the manufacture of [a fixed dose combination tablet], and to sell [this pharmaceutical product] for export to [Rwanda]".

Another example is the patentability of human embryonic stem cells. On page 94, Van Overwalle refers to a case pending before the Enlarged Board of Appeal of

the European Patent Office. Meanwhile, the Enlarged Board of Appeal has delivered its decision, on 25 November 2008.[3] This decision brought some most important clarifications, but left equally momentous questions deliberately unanswered. The Enlarged Board of Appeal held, inter alia, that human embryonic stem cell cultures, the preparation of which inevitably necessitates, according to the patent application, the destruction of human embryos, are excluded from patentability.

Although Van Overwalle's contribution is most well informed, we do not agree with her plea to abolish Article 6(2) of the EU Biotechnology Directive (98/44/EC). The author bases her opinion on the proposition that "a direct link is missing in Article 6(2) between ethics and patents" (p. 95). According to Van Overwalle's understanding, Article 6(2) "wishes to exclude certain fields of research as such" (p. 95). We are not convinced. Article 6(2) of the EU Biotechnology Directive is simply a concretion of Article 6(1) of the same directive. Article 6(1), in turn, which provides that "Inventions shall be considered unpatentable where their commercial exploitation would be contrary to ordre public or morality [sic!]" clearly is a "link . . .between ethics and patents".

Finally, one could have been more critical with regard to opinion no. 16 adopted by the European Group on Ethics in Science and New Technologies (EGE) concerning "ethical aspects of patenting inventions involving human embryonic stem cells". Of course, Van Overwalle does not fail to disclose that she provided the preparatory study for this opinion. Nevertheless, the opinion is highly debatable. It may be defensible as a purely ethical opinion. But it has to be pointed out that parts of the opinion clearly contradict the EU Biotechnology Directive. According to this directive, human cells (e.g. embryonic stems cells) are patentable whether they are modified or not. In contrast, the EGE opinion holds that stem cells are patentable only if they "have been modified by in vitro treatments or genetically modified". It is also most astonishing that the EGE was of the opinion that there was "no specific ethical obstacle" to the patenting of "processes involving human stem cells, whatever their source". What if such processes always and unavoidably depend on the destruction of human embryos to obtain the human stem cells which form the starting material for the patented process?

5. Emmanuel Opoku Awuku's inspiring contribution focuses on "African perspectives" on "Intellectual property rights, biotechnology and development" (pp. 109 et seq.). More specifically, the author sketches the African perspective on the importance of agrobiotechnology for food supply and development and, thus, for the reduction of poverty.

He vividly describes the specific African agricultural situation which is characterized, e.g. by small-scale farming, informal exchange of seeds and selective breeding of plant varieties by farming communities (pp. 111–112). With regard to these regional peculiarities, Opoku Awuku advocates legal instruments which

[3]Enlarged Board of Appeal, G 2/06, *Wisconsin Alumni Research Foundation*, 2009 Official Journal EPO 2009, p. 306.

specifically protect traditional knowledge, innovations and practices both of indigenous peoples and of small-scale farmers as well as of local farming communities. According to the author, existing international instruments such as the International Convention for the Protection of New Varieties of Plants of 1991 (UPOV Convention) are not really responsive to the needs of African agriculture. In contrast, the African model law adopted by the African Union (AU) apparently takes into account the specific African regulatory interests (pp. 112–113). This model law "was intended to assist African states in their effort to adopt an effective *sui generis* system for the protection of plant varieties and farmers' rights" (p. 112). More specifically, the model law provides that local communities enjoy collective rights over their biological resources and their traditional knowledge and technologies. These collective rights "take precedence over rights based on private interests" (p. 112), e.g. if we are not mistaken, over IPRs. Opoku Awuku admits, however, that the AU African model law has not found much acceptance among African states. African states apparently rather ratified the TRIPS Agreement or the UPOV Convention (p. 115). In fact, the African model law seems to be not consistent with the UPOV Convention and the TRIPS Agreement in all respects (cf. p. 114). Part III, section 9.1, of the model law, e.g. provides that "patents over life forms and biological processes are not recognized and cannot be applied for" (p. 113). That rule is, in our opinion, hardly defendable under Article 27 of the TRIPS Agreement.

6. Traditional knowledge and its protection are discussed in depth by Federico Lenzerini. His most exciting article on "Traditional knowledge, biogenetic resources, genetic engineering and intellectual property" (pp. 118 et seq.) explores, first of all, the concept and nature of traditional knowledge (pp. 118–123). Unfortunately, the author does not provide us with a clear-cut definition of the term "traditional knowledge". He explains that "it is not easy to provide a clear and comprehensive definition of [traditional knowledge]" (p. 118) because there are "clearly innumerable forms of [traditional knowledge]" (p. 119) which cannot be packed into one all-encompassing definition. However, and most interestingly, the author highlights one important element: traditional knowledge is an intellectual manifestation that "is perceived by the community concerned as part of its own traditional cultural and/or social heritage" (p. 119). If we tried to derive our own definition of traditional knowledge from Lenzerini's instructive presentations, we would define traditional knowledge as indigenous peoples' knowledge which relates to biological resources and their use and which forms an integral and unalienable part of those peoples' cultural tradition.

Lenzerini, subsequently, addresses the problem of "biopiracy", i.e. of the unlawful appropriation of traditional knowledge (p. 122). It is, however, not readily conceivable why misappropriation of traditional knowledge amounts to a "violation of the deep cultural identity" of the indigenous people concerned (p. 122). From our point of view, the illegal appropriation of traditional knowledge by some lawless bioprospectors does not imply that the indigenous people concerned have actually lost their traditional knowledge. The people are typically still in full "intellectual possession" of their traditional knowledge. Thus, as long as they still possess their traditional knowledge, their cultural identity cannot be really impaired.

It is, equally, not readily conceivable why holders of traditional knowledge "are usually considered as commercial competitors" once traditional knowledge "has been misappropriated and patented". Traditional knowledge *as such* is not patentable. It is not an invention within the meaning of, e.g. Article 27(1) of the TRIPS Agreement. Traditional knowledge is, obviously, not new. And we are also unable to identify an innovative step. Apparently, the author is well aware of this fact (cf. p. 138). This is the very reason why "patents concerning 'inventions' which are no more than the appropriation of pre-existing [traditional knowledge]" have been, quite correctly, revoked (p. 131). Of course, traditional knowledge may form the essential basis for an invention. For example, indigenous people possess the traditional knowledge that a particular plant can be used to cure a given disease. Let us also assume that the therapeutic effect depends on a protein to be found in the plant. A pharmaceutical company then isolates the gene which encodes for the protein and inserts the gene into bacteria, which henceforth produce the protein, which, in turn, will be used as the active pharmaceutical ingredient of a new drug. The fact that indigenous people knew about the curative effect of the plant does not prevent the patentability of the plant's gene. The patent, of course, only covers the gene in its technically isolated form but not the gene in situ. Thus, the patent holder, i.e. the pharmaceutical company, cannot enjoin the indigenous people from continuing to use the plant as such (i.e. as it occurs in nature) in accordance with their traditional knowledge for medical purposes. It follows that the indigenous people are not competitors of the pharmaceutical company. What is more, they also do not need a licence from the patentee to make continuing use of their traditional knowledge.

Our question with regard to traditional knowledge is: Who is actually interested in the protection of traditional knowledge, e.g. in the form of an IPR? If we all agree that indigenous people do not perceive their natural resources as "a commodity with a mere commercial value", why should they be bothered by a patent held, e.g. by a Swiss pharmaceutical company, and be interested in an "equitable sharing of benefits" (p. 145)? Any such benefit-sharing would amount to a commercialization of nature. We opine, therefore, that it is rather the state (or its government or its political elite etc.) within which the indigenous people reside that is interested in receiving benefits from the appropriation of traditional knowledge by "Western" (or "Northern") bioprospectors.

That does, of course, not militate against Lenzerini's call for an international legal framework for the protection of traditional knowledge. He advocates a sui generis intellectual property regime (pp. 137, 139) and provides us with copious details on the content of such an international framework (pp. 141–147).

7. Simonetta Zarrilli sheds light on "Biotechnology in the energy sector" (pp. 151 et seq.) with a particular focus on the "implications for developing countries". In fact, with regard to "the energy challenge of this century" (p. 154), the adverse impact of fossil fuels, e.g. on the world's climate, and the fact that fossil fuels are by their very nature exhaustible, new sources of renewable energy have to be found. So-called biofuels, such as ethanol and biodiesel, may be a seminal option to replace traditional petrol and diesel fuel (cf. pp. 155–159). The cost-effective

production of biofuels depends, of course, on plants specifically bred for energy purposes (cf. p. 159). Modern biotechnology, in particular genetic engineering, may be the key to the necessary pinpoint modifications of plants (cf. p. 160). At this point, the developing countries come into play. Zarrilli argues (and we agree) that, "[f]or biotechnology to contribute to overall development, developing countries should become able to play a role in the agro-biotechnological process of selecting and improving plant traits to make them more suitable for energy production. They should also switch from exporting the raw materials to producing final products, such as biofuels" (p. 163). Of course, that "necessitate[s] availability and a command of the relevant technology" (p. 163).

Once GM plants or biofuels produced from such plants are exported to developed countries, regulatory problems will be pending. Despite their notorious hunger for energy, GMO-averse states or regions such as the EU might be unwilling to grant market access to GM crops or biofuels derived from GM plants. Trade in such products is "covered by the same disciplines that govern trade in goods in general, and trade in agro-biotechnology products in particular" (p. 166). Therefore, GATT, the SPS Agreement and the TBT Agreement as well as the CPB apply (cf. p. 166). Indeed, with the exception of "fuel wood" [cf. Article 1(4) and Annex EM of the Energy Charter Treaty (ECT)], biofuels apparently do not constitute "energy materials" or "energy products" within the meaning of the ECT and are, thus, not subject to the trade rules of the ECT.

Zarrilli's account of the pertinent provisions of the CPB and WTO law (pp. 167–173) is very well informed and most instructive. In particular and most laudably, she takes the WTO Panel's decision in the *Biotech Products* case into consideration. One of Zarrilli's conclusions is that "[t]he Panel seems to have set up a new interpretation regarding the crucial issue of the interface between WTO agreements and other sources of international law, including [MEAs]" (p. 172). In fact, on the basis of Article 31(3)(c) of the VCLT, the WTO Panel declined to apply the CPB because not all WTO members were parties to that treaty. In the case of a WTO dispute, this may redound to the disadvantage especially of developing countries, many of which have implemented the CPB by adopting strict regulations concerning the transboundary movement of GMOs (cf. pp. 172–173).

8. Anne Petitpierre-Sauvain deals with one of most hotly debated issues in the field of biotechnology regulation: coexistence and liability (pp. 175 et seq.). Indeed, "[c]oexistence in agriculture is an old problem" (p. 175). Any cultivation of a given field may adversely affect the neighbouring fields and their use. This is particularly true, e.g. with regard to seed production. Seeds may be marketed only if "contaminations" by other varieties do not exceed certain minimal thresholds. Therefore, seed production depends on agricultural practices which minimize the risk of such "pollution".

In the case of genetic engineering, coexistence means, first of all, that farmers should have the choice to apply their preferred agricultural production method be it the cultivation of GM crops, organic farming or the growing of conventional crops. Owing to the possibility of gene flow, however, cultivation of GMOs may seriously undermine efforts of neighbouring farmers to produce GMO-free commodities.

Thus, coexistence is basically a socio-economic concern. Petitpierre-Sauvain, however, adds another aspect (cf. pp. 177–178). In fact, agricultural production methods may also harm the environment, in particular biological diversity. Therefore, the concept of coexistence may be extended to natural conservation concerns.

By way of example, the author subsequently refers to the Canadian *Schmeiser* case[4] (pp. 178–182). Actually, this case only refers to the socio-economic dimension of coexistence. Furthermore, it is, in our opinion, not a "typical" coexistence case. The dispute decided by the Supreme Court of Canada arose not between neighbouring farmers owing to alleged "transgenic contamination" but between a farmer, Mr. Schmeiser, and Monsanto owing to alleged patent infringement. The author, of course, is well aware that the *Schmeiser* case concerns legal problems of intellectual property protection (cf. p. 179). The only link between the *Schmeiser* case and coexistence is the fact that GM rapeseed cultivated on nearby fields unintentionally spread to Schmeiser's fields.

Thereafter, Petitpierre-Sauvain directs the reader's attention to the Swiss rules on strict liability for damages caused by GMOs (pp. 182–190). She explains that, under the Swiss Gene Technology Law, "liability is . . . channeled to the licence holder" (p. 187), i.e. to the company or person who obtained the approval to place the GMO on the market. Most interestingly, this rule also applies to coexistence liability, i.e. to liability for damages caused, e.g. by unintentional gene flow between neighbouring fields. Thus, "[liability] is *no longer connected* with the problems of *coexistence* between *neighbours*" (p. 187). From a German perspective, the German legislator would be well advised to consider an amendment to the German law on genetic engineering in accordance with the Swiss liability regime, which is, in our view, a very instructive and felicitous model.

Petitpierre-Sauvain finally turns to the question of whether and to what extent national GMO policies are consistent with WTO law (pp. 190–192). She assumes that "[b]oth the burden of proof and the nature of the evidence are different in the two systems" (p. 191). In fact, on the national level, it is generally the producer of the GMO who has to prove that the GMO is safe to human health and the environment. If the national authority competent for granting marketing approvals is not persuaded of the GMO's safety, it will deny the approval. On the other hand, on the international level, it will be the state whose authority has rejected the GMO producer's application for marketing approval which will have to prove that such denial was based on a proper scientific risk assessment (cf. p. 191). In the author's opinion, "there would be very little evidence available for the State to prove (as it has to under WTO rules) that the refusal of a certain variety is based on 'sound scientific evidence' that it is detrimental to the local biodiversity" (p. 191). We hesitate to agree. When submitting an application for marketing approval, the GMO producer will typically provide an extensive scientific risk assessment dossier substantiating the safety of the GMO. Once the applicant has made a scientifically convincing case that the GMO is safe to human health and the environment, the

[4]Supreme Court of Canada, *Monsanto v. Schmeiser*, [2004] SCC, p. 34.

burden of proof shifts to the competent authority. If the competent authority considers rejecting the application, it will have to base its decision on “sound scientific evidence” invalidating the applicant’s risk assessment. Thus, we think that in the case of a WTO dispute the state whose competent authority had declined to grant marketing approval for a given GMO should be well prepared to justify its decision by referring to “sound scientific evidence”.

Finally, we find some difficulty in being persuaded by the author’s differentiation between “organisms” and “products” (pp. 191–192). Petitpierre-Sauvain’s assumption seems to be that a self-consistent national legal framework for “organisms” (e.g. GMOs) is immune against challenges under WTO law, which allegedly applies to “products” only. We opine that “organisms” (e.g. GMOs) become “products” (“goods”) once the “organisms” become objects of international trade. Nevertheless, in the case of modern biotechnology, we find some truth in distinguishing an “organisms” approach from a “products” approach inasmuch as the issue behind this distinction is, in our opinion, the problem of how to reconcile environmental law with world trade law.

9. In his article entitled “Food security and agricultural production with genetically modified organisms” (pp. 193 et seq.), Michael Hahn clearly spells out the Janus-faced nature of biotechnology with regard to food security, especially with regard to the human rights obligations to respect and to ensure the right to food (cf. pp. 193–195). Indeed, with regard to food security, GMOs may be a boon and a bane at the same time (pp. 195–196).

His further remarks concern the relationship between WTO law and the CPB. One may question whether the characterization of the CPB as a “trade agreement” (p. 198) is correct in every respect. In our opinion, the CPB is an environmental agreement which is tied up to any kind of transboundary movement (including international trade) of GMOs. In any case, Hahn correctly points to the tension between WTO law and the CPB. In fact, the CPB may thwart WTO rules by preferring national sovereignty over liberalization of international trade. It is also perfectly true that the conflict between WTO law and the CPB mirrors the gradual fragmentation of public international law. In fact, the “growing trend towards differentiation . . . requires structures which . . . allow harmonized decisions in the end” (p. 201). However, Hahn does not seem to be very optimistic whether such harmonization may be achieved within the WTO dispute settlement framework (cf. p. 201).

Finally, one might willingly support Hahn’s call for a better balanced equilibrium between intellectual property protection and conflicting interests and values, e.g. of indigenous peoples, with regard to the oligopolistic structure of the biotechnology industry dominated by a few global players (pp. 201–202).

10. “Trade, environment and biotechnology: on coexistence and coherence” (pp. 205 et seq.) is the subject of Laurence Boisson de Chazournes and Makane Moïse Mbengue’s contribution. Their article underlines the importance of legal theory in the field of public international law. It is concerned with the relationship between MEAs and WTO law. This relationship is particularly pertinent in the case of GMOs because “the international regulation of biotechnology is at the crossroads

of trade and environment" (p. 208). What is more, the relationship between MEAs and WTO law is directly linked to the current debate on the fragmentation of public international law.

The authors' central thesis is that "there is no *a priori* conflict between MEAs and WTO law" (p. 207) and that any "idea ... of a real conflict between WTO Agreements and MEAs belongs more to the domain of myth than to reality" (p. 212). This provocative thesis is further elaborated on and substantiated by the authors on the following pages. The reasoning relies principally on the "presumption against conflicts between MEAs and the WTO Agreements" (pp. 216–217), which, in turn, is based on the more general "presumption against conflict of norms" in general international law (pp. 218–219).

However, in our opinion, it seems somewhat doubtful whether such a "presumption against conflict of norms" really exists in *general* international law. It is revealing that the conclusions of the work of the Study Group on the Fragmentation of International Law, which were adopted by the International Law Commission in 2006, do not mention such a "presumption against conflicts of norms" at all. In fact, long-established general rules such as *lex specialis derogat legi generali*, *lex posterior derogat legi priori* and *lex superior derogat legi inferiori* obviously imply that conflicts of norms do exist within any given legal order. The very purpose of such a rule is to resolve such conflicts. We think that whether or not there is a conflict of norms cannot be determined on the basis of general and abstract presumptions, but only with regard to the concrete norms applicable in a given case. However, before a conflict of norms can be asserted, the norms have to be interpreted. A "harmonious" interpretation of the applicable norms may lead to the result that they do not impose, e.g. mutually exclusive obligations and are, thus, not in normative conflict with one another.

The interpretation of norms may be guided by the language of preambles of international treaties. In fact, preambles of MEAs provide that the treaty "shall not be interpreted as implying a change in the rights and obligations of a Party under any existing international agreements" (preamble of the CPB). One may derive from such clauses the principle of not adding or not diminishing the rights and obligations provided by other international agreements (p. 222). The authors point out that this principle rules out the invocation of rules of conflict such as *lex specialis*, *lex posterior* and *lex superior* (pp. 223–227). On the basis of the aforementioned principle, MEAs, e.g. the CPB, and WTO law stand side by side on an equal footing.

Nevertheless, conflicts of norms may arise "where a rule in one agreement prohibits what a rule in another agreement explicitly permits" (p. 221 citing the WTO Panel report in the *EC Bananas* case). Such a situation may occur in the case of socio-economic considerations. Article 26(1) of the CPB explicitly permits that "[t]he Parties, in reaching a decision on import under this Protocol or under its domestic measures implementing the Protocol, may take into account, consistent with their international obligations, socio-economic considerations arising from the impact of living modified organisms on the conservation and sustainable use of biological diversity, especially with regard to the value of biological diversity to

indigenous and local communities". A ban on imports of GMOs based on socio-economic considerations may be incompatible with WTO law though. We fail to see whether and to what extent the "principle of mutual supportiveness" (p. 228) may be of help in such a situation. In any case, the "principle of mutual supportiveness" is of no avail, if a WTO panel or the Appellate Body declines to take the CPB into consideration. In fact, in the *Biotech Products* case, the panel dismissed the EU's proposition to apply the CPB for purposes of interpretation in accordance with Article 31(3)(c) VCLT because not all WTO members are parties to the CPB.

Interestingly, however, the authors would like to give a practical meaning to the "principle of mutual supportiveness" by proposing a "way of promoting mutual supportiveness" (p. 231). Their proposition is that the concept of "mutual supportiveness" should be implemented by way of standardization. In fact, the CPB may be perceived as an "international standard" (cf. pp. 232–235). Very generally speaking, adherence to international standards is tantamount to being in conformity with WTO law [cf. Article 3(2) of the SPS Agreement; Article 2(5) of the TBT Agreement]. However, the authors acknowledge that the CPB has not been identified as an "international standard" within the meaning of the SPS Agreement by the SPS Committee (pp. 232–233). Nevertheless, they opine that a state may invoke the CPB "as an international standard as such which is applicable under Article 3(2) of the SPS Agreement, but also because it reflects the 'contemporary concerns of the community of nations'" (p. 233). This argument seems to be debatable. The meaning of the term "international standard" is strictly confined to its definition in Annex A(3) of the SPS Agreement [Article 1(2) and (3) of the SPS Agreement]. According to this definition, the CPB is supposedly not an international standard within the meaning of the SPS Agreement. The CPB has neither been "identified by the [SPS] Committee" nor "promulgated by [an] international organization [..]" [cf. Annex A(3)(d) of the SPS Agreement]. In addition, it does not seem to be beyond any doubt that the CPB mirrors the 'contemporary concerns of the community of nations'. Major global players in the field of modern biotechnology such as the USA, Argentina and Canada are not parties to that treaty.

The final part of the article provides us with a very knowledgeable assessment of the compatibility of biotechnology regulations with the WTO agreements (pp. 237–244). The authors opine that the CPB is applicable in a WTO dispute. In contrast, as pointed out earlier, the WTO Panel rejected the applicability of the CPB in the *Biotech Products* case.

11. Franz Xaver Perrez deals with "Risk regulation, precaution and trade" (pp. 246 et seq.). This very well balanced article is extraordinarily instructive. If one dared to utter criticism, one would have to point to the fact that the article only rather rarely refers to the overall topic of the volume, i.e. genetic engineering.

Perrez starts with an elucidation of the concepts of "risk regulation", "precaution" and "trade" (pp. 247–267). The author correctly states that sound risk regulation ought to be based on an assessment of risks and benefits and that, with regard to modern technologies, "risk assessment increasingly involves situations of uncertainty" (p. 249). The following thesis, however, deserves closer scrutiny. Perrez opines "that the fewer the uncertainties, the more risk regulation can be directly

based on risk assessment, and the greater the uncertainties, the more risk regulation must also take into account considerations other than the information provided by the risk assessment" (p. 250). It is not our intention to challenge this thesis as such. However, we would simply like to ask whether and to what extent risk regulation may rely on "considerations other than information provided by the risk assessment", e.g. on socio-economic considerations, also in cases of marginal uncertainty.

One more feature of Perrez's remarks concerning the concept of risk regulation deserves attention. From a European perspective it is, indeed, common place to distinguish between GM products and "traditional products". The latter are typically not subject to a regulatory regime as strict as that of the legal framework which governs GMOs. But what is the meaning of a "traditional" product (or "traditional" technology)? The following case may shed some light on this question (but not on the answer to it). On 2 March 2010, the European Commission approved the marketing of the GM potato Amflora developed by BASF.[5] The approval procedure lasted almost 14 years. Only a few days before the marketing approval was issued, the *Süddeutsche Zeitung* announced that the company Bioplant had succeeded in breeding a potato possessing the same traits as the Amflora potato.[6] Like BASF, Bioplant switched off the gene which encodes for the protein amylose. However, Bioplant did not employ genetic engineering techniques. Instead, Bioplant's breeders treated thousands of plants with chemicals and X-rays. Obviously, such treatment generates random gene mutations. By means of special analysis methods, those plants expressing the traits sought after are identified. The amylose-free potato developed by Bioplant is neither subject to a technology-specific approval procedure nor is its cultivation subject to technology-specific rules. Is the Bioplant potato a "traditional" product? Does chemical or X-ray treatment of plants amount to "traditional" breeding? Are not chemicals and X-rays notoriously dangerous to human health and the environment? Why does such a breeding technology not deserve a similar regulatory framework comparable to the regime which applies to genetic engineering?

Perrez continues to elaborate on the concept of "precaution", distinguishing precaution from "prevention" (p. 254). The origins of the concept are carefully traced back (pp. 252–254). Likewise, the concept's essential elements are exhaustively compiled (pp. 256–258). We perfectly agree that the concept of precaution "can be seen as a general principle of law common to the major legal systems of the world" and that "there also seems to be agreement that precaution is in the process of crystallizing into a rule of international customary law" (p. 260).

Having presented the concepts of "risk regulation", "precaution" and "trade", Perrez continues to describe the relationship between environment and trade (pp. 263–280). According to Perrez, this relationship is governed by the principles of "no hierarchy", "mutual supportiveness" and "deference", meaning that there is

[5] Press Release IP/10/222, 2 March 2010: Commission announces upcoming proposal on choice for Member States to cultivate or not GMO's and approves 5 decisions on GMO's.

[6] Konkurrenz für die Gentech-Knolle, Süddeutsche Zeitung, 18 February 2010, p. 16.

no hierarchy between WTO law and MEAs, that WTO law and MEAs are complementary and mutually supportive and that both regimes, i.e. the trade regime as well as the environment regime, should show deference towards one another "by not judging the legitimacy or the necessity of measures adopted by the other regime" (pp. 275–276). Indeed, the relationship between the CPB and WTO law can be described in terms of these three principles (cf. pp. 276–277). What is more, both the international environmental regime and the trade regime "pursue the same overarching objectives [sc. sustainable development and well-being of humans] while focusing on different means" (p. 269). Although one might assume that the trade–environment debate is settled once and for all on the basis of these principles, the author is well aware that "there is still great nervousness about the relationship between MEAs and the WTO" (p. 272). There is certainly some truth in Perrez's conclusion that "the trade-environment debate does not reflect a shared understanding that trade and environment must conflict, but a lack of trust between partners that rules and measures agreed upon for the purposes of environmental protection will not be misused for illegitimate trade interests" (p. 274).

Perrez finally explores the relationship between WTO law and the concept of precaution. Interestingly (and, in our opinion, correctly), Perrez concludes that the concept of precaution is not only laid down in the SPS Agreement [cf. Article 5(7)] but is also implicitly referred to by the "necessity" requirement under both the GATT and the TBT Agreement: "In fact, in situations of scientific uncertainty, but where there are indications of serious risk, it would be unsound to say that taking protective measures is unnecessary to achieve a certain level of protection" (p. 282).

12. The article by Roger Brownsword concerns "Genetic engineering, free trade and human rights: global standards and local ethics" (pp. 287 et seq.). His contribution focuses on the tension between international guarantees of free trade (in goods or services) and national exceptions to free trade justified under reference to human rights and, in particular, human dignity. In fact, both Article XX(a) GATT and Article XIV(a) GATS allow for exceptions necessary to protect "public morals" (cf. p. 288). The term "public morals" is broad enough to embrace human rights and human dignity. At this point, one may legitimately pose the question whether "if respect for human rights and human dignity ... sets the standard for imposing legitimate restrictions on trade, [there is] any scope for local variations or [whether] such principled restrictions [can] apply only in a cosmopolitan way?" (p. 289). The author persuasively concludes that the morality exceptions to free trade will not result in uniform exceptions throughout the whole international community.

Brownsword distinguishes between two opposed conceptions of human dignity (pp. 292–300). One conceives "human dignity as empowerment", the other conceives "human dignity as constraint". According to the author, the concept of "human dignity as empowerment" is firmly embedded in the human rights tradition and supports individual autonomy. In contrast, the concept of "human dignity as constraint" pursues a duty-driven approach and acts as a constraint on individual autonomy. The author continues to associate these antithetic conceptions of human dignity with differing kinds of "communities". The concept of "human dignity as empowerment" is linked to a "rights-driven community" (or "community of rights"),

whereas the concept of "human dignity as constraint" is linked to a "duty-driven community" (or "dignitarian community"). The "rights-driven community" is committed to maximizing individual freedom, which may be restricted only for the sake of conflicting rights of others. In contrast, the "duty-driven community" has as its "first priority ... to ensure that duty is done; there is no sense of loss as freedom is reduced for the sake of dignitarian duty. ... [F]reedom is simply what is left over to the individual when his or her duties have been fully itemised" (p. 298).

Despite these fundamental differences between "rights-driven communities" ("communities of rights") and "duty-driven communities" ("dignitarian communities"), the author has to admit that both communities may reach the same conclusions with regard to the same bioethical problem (cf. pp. 297, 308–309, 312). In contrast, however, considering "the test-case of therapeutic cloning", Brownsword claims that "we might expect a community of rights to take a permissive view, diverging from the restrictive view taken by a dignitarian community" (p. 310). The reasoning behind this conclusion depends, of course, on a very specific and almost totalitarian pattern of "duty-driven" or "dignitarian community". It must be a community which firmly rests on "the principle of the sanctity of human life (interpreted broadly so that, inter alia, it commands protection of human embryonic and fetal life)" (p. 295). But is it an inalienable prerequisite of a "duty-driven" or "dignitarian community" that it is committed to extend "the dignity of human life all the way from conception to the grave" (p. 309)? If so, "duty-driven communities" ("dignitarian communities") seem to be constituted always and exclusively by radical conservatives (or conservative radicals).

Moreover, in the author's opinion, "duty-driven dignitarian exceptions" to free trade are obviously incompatible with the international community's commitment to respect human rights (p. 314). Does that imply that "duty-driven communities" ("dignitarian communities") are generally not able to invoke the "public moral" exceptions to free trade? In addition, it is not clear whether Brownsword merely intends to structure the bioethical debate or whether his intention is to paint a picture of the real world which falls apart into two categories of communities with oppositional conceptions of human dignity. The latter seems to hold true because, according to the author, "the failure of the United Nations to achieve a consensus against cloning is explained, in part [sic!], by this tension [sc. between human dignity as empowerment and human dignity as constraint]" (p. 296).

From a German perspective, it would be interesting to know whether the author would classify Germany as a "rights-driven community" or as a "duty-driven community". The answer may depend on the viewpoint. From a sociological viewpoint, taking into account, e.g. the public debate on bioethics, one might be apt to qualify Germany as a "duty-driven community". From a legal viewpoint, however, taking into account constitutional law as interpreted by the Federal Constitutional Court, we are convinced that Germany ought to be classified rather as a "rights-driven community". More specifically, the constitutional guarantee of human dignity itself, i.e. Article 1(1) of the German constitution, is perceived as a human right.

Brownsword continues to elaborate more on the "community of rights" (pp. 300–304). Such a community will have to discuss the rights to be recognized as well as their scope and their holders. Other questions to be addressed are whether rights should apply only vertically (between the government and the private individual) or also horizontally (between private individuals), the way in which conflicts between rights are to be settled, the requirements for legitimate infringements of those rights and whether and to what extent individuals have positive responsibilities to one another. The author concludes that "if each community is seeking, in good faith, to arrive at its best understanding of its commitment to human rights, there can be no guarantee that the answers arrived at will be the same everywhere. And this allows for the possibility of distinctive human-rights-based local restrictions on trade" (p. 304). Does that also mean, as a consequence, that states enjoy a considerable margin of appreciation when making use of "public moral" exceptions to free trade?

The author continues to explore the relationship between human dignity and human rights (pp. 304–308). In his opinion, human dignity should not be restricted to be the justificatory basis for human rights. Rather, "human dignity should be viewed as an essential condition for the existence of any moral community, including a community of rights" (p. 305). On the basis of Immanuel Kant's concept of moral autonomy, the author suggests that an essential feature of a moral community is that "citizens who aspire to do the right thing also have the opportunity to do the wrong thing" (p. 306). From this starting point the author reaches some important and rather convincing conclusions. For example, with regard to genetic enhancement, the author argues that citizens should not be "coded for compliance", because "they will no longer have the option to do wrong and there will be no virtue in their doing right" (p. 308). To preserve the conditions for moral community, communities of rights "might impose restrictions on the trade in biotechnological goods and services as an act of self-defence to prevent the breakdown of the very conditions of moral order itself" (p. 308).

13. Souheil El-Zein discusses "The regulation of human genetics by international soft law and international trade" (pp. 325 et seq.). The author explores the significance of soft law instruments adopted by UNESCO and their impact on WTO law. In the field of human genetics, the following UNESCO declarations are of importance (cf. p. 318): the Universal Declaration on the Human Genome and Human Rights (1997; henceforth: human genome declaration), the International Declaration on Human Genetic Data (2003) and the Universal Declaration on Bioethics and Human Rights (2005). These declarations are not legally binding (p. 320). The author explains why UNESCO opted for non-binding instruments by pointing to the prudent approach adopted by UNESCO (p. 319). In fact, this "prudent approach" is certainly justified. Any efforts to agree on a binding international treaty regulating such a complex and ethically explosive issue as human genetics would have been very probably all in vain.

Nevertheless, one is tempted to ask what the fruits of legally non-binding international instruments actually are. El-Zein's answer is that the UNESCO declarations' "originality lies in their aim to guide States in adopting uniform legislation and to influence the settlement of many conflicts between principles

confirmed by human rights instruments and those relating to international trade and freedom of research by reminding States and the private sector of the importance of ethical principles being integrated into existing law" (p. 320). The article is, however, somewhat silent on whether this aim has come true.

Utterly fundamental bioethical problems such as the status of the human embryo are so contentious that it is impossible to ascertain any international consensus. The author correctly mentions that, on the international level, the right to life and the guarantee of human dignity do not apply to the human embryo (p. 322). On the other hand, the international community unanimously bans reproductive cloning because it being irreconcilable with human dignity. El-Zein defends this position explaining that the "use of the concept of human dignity as a constraint for reproductive cloning has many objective justifications derived from the Articles of the UNESCO Declarations supported by a large international consensus" (p. 323). One may conclude from this statement that, at least with regard to reproductive cloning, the international community seems to be a "duty-driven community" or "dignitarian community" (see Brownsword's contribution, supra, pp. 287 et seq.).

The author continues to explain that, within the framework of the UNESCO declarations, the concept of human dignity has been closely linked to the concept of "heritage of humanity" (p. 324). Human dignity is "proclaimed for humanity as a whole" (p. 324) and "the common interests of humanity [are] covered by the concept of human dignity" (p. 326). Thus, it appears that both human dignity and (the heritage of) humanity have developed into concepts which may be emplaced so as to strictly curtail individual freedom: human dignity dictates that "the free will of any individual seeking to be cloned, even with his or her own consent", must be restricted (p. 322). And the "concept of heritage of humanity [is] used . . . not to limit the excess of States' sovereignty over spaces of communal interest, but explicitly as a limitation on the potential of individuals to dispose of their human genome at will" (p. 326). For the sake of moral autonomy of the individual, we hope that the tyranny of human dignity and humanity does not go any further.

Besides, the wording "heritage of humanity" is somewhat misleading. Despite its similarity with "common heritage of humankind" the concept of "heritage of humanity" has legal implications completely different from those of the older concept of "common heritage of humankind". The very purpose classifying the human genome as "heritage of humanity" (Article 1 of the human genome declaration) "is precisely to prevent the human genome becoming no more than a natural resource which could become somebody's property by means of the conclusion of a sale contract, or royalties, against any service derived from the exploitation of such genetic resources" (p. 327). Thus, the concept of "heritage of humanity" specifically concretizes the broader "principle of non-appropriation of the human body and its elements" with regard to the human genome. This "principle of non-appropriation" does, however, not foreclose that "an isolated part of the body, or a gene sequence, . . . can be the subject of donation [sic!] for medical or scientific research" (pp. 327–328).

Things become more complicated, of course, when it comes to patenting human genes because the patenting of human genes might be qualified as an appropriation

of (parts of) the human body. Furthermore, Article 4 of the human genome declaration provides that the "human genome in its natural state shall not give rise to financial gain". However, the author correctly assumes that human genes or human gene sequences isolated from the human body or assembled artificially in vitro are patentable. Indeed, the patentability of such genes or gene sequences is not contrary to the human genome declaration, which only refers to the human genome "in its natural state". The phrase "in its natural state" signifies not only that the genome as a whole is not patentable (p. 337), but also that it is solely the genes and gene sequences "in situ", i.e. in their natural environment, which are exempt from patentability.

Finally, the author does, in general, not see causes for conflict between WTO law and the UNESCO declarations' quest for solidarity between states which are encouraged to enter into agreements on the sharing of scientific knowledge and information. Indeed, cross-border exchange of scientific knowledge and information could amount to providing "services" within the meaning of GATS (p. 334). That depends, of course, on how the term "services" is defined and construed [cf. Article 1(3)(b) GATS]. Unfortunately, the author does not elaborate more on this "hypothetical question" (p. 334).

III.

We signalized right at the beginning of this review that some critical remarks are inevitable. Nevertheless, we would like to conclude that the volume continuously presents very well drafted, knowledgeable and illuminative contributions. Anyone interested in world trade law and its bearing on modern biotechnology regulation will highly profit from reading the articles, which are still largely state of the art.

Simon Lester and Bryan Mercurio with Arwel Dawies and Kara Leitner, World Trade Law: Text, Materials and Commentary

Markus Krajewski

The growing practical importance of international economic law and the rising scholarly interest in this subdiscipline of public international law – aptly demonstrated by the successful launch of this yearbook – could not have been without impact on academic teaching of the subject. New courses at undergraduate and postgraduate levels have been established at universities worldwide; international economic law is no longer a field only taught to master's degree students at a few specialized universities in the USA and Europe. The "mainstreaming" of international economic law into law school curricula, i.e. the inclusion of the subject into general undergraduate programmes, is on the rise. Arguably, the number of students studying international economic law, and the law of the Word Trade Organization (WTO) in particular, may have never been as high as in recent years. As a consequence, these are (intellectually and financially) rewarding times to write and publish teaching material on international economic law. Yet, the market is becoming increasingly contested and competition among the leading textbooks is fierce. For those teaching and those studying international economic law, this is good news, because it enables them to select books which serve their respective educational objectives best. From this perspective, the publication of a new textbook on international trade law is always a welcome addition to an already wide and diverse choice of books.

Simon Lester and Bryan Mercurio's *World Trade Law – Texts, Materials and Commentary* written together with Arwel Davies and Kara Leitner is a comprehensive and factual treatise covering all aspects of the law of the WTO, but nothing else. Even though the authors note the growing importance of bilateral and regional trade agreements as well as the rise of investment law and its merger with trade law in some regional agreements (pp. 3–4), the book focuses on the WTO as "an umbrella under which almost everything else falls" (p. 4). One could have added that most bilateral and regional trade agreements are built upon the model of the WTO, which makes studying the principles of the WTO a useful exercise for the

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_23, © Springer-Verlag Berlin Heidelberg 2011

analysis of regional agreements. Yet, it should be noted at the outset that the book's main target group is courses of WTO law. Given the size of the book (892 pages), it is a stand-alone text which will find its main area of use most likely in a year-long course at the master's degree or advanced undergraduate level.

The book is structured in a logical and concise manner. The first quarter of the book covers the legal and economic basis of the world trading system (Chaps. 1, 2, 4 and 5), its historical development and institutional structure (Chap. 3) and dispute settlement (Chap. 6). Roughly another quarter is devoted to the core GATT principles, i.e. tariffs, quotas and non-discrimination (Chaps. 7 and 8) and to GATT exceptions, which include Articles XX and XXIV GATS (Chaps. 9 and 10). Three chapters of roughly equal length cover trade remedies (subsidies, dumping and safeguards) in a sufficiently detailed way. Next follows a part entitled "Beyond trade in goods". Somewhat surprisingly, this heading also covers the TBT, SPS and TRIMS agreements, which may go beyond traditional trade measures, but certainly not beyond goods. This part also contains chapters on services, government procurement and TRIPS. The order of the chapters seems somewhat arbitrary, but readers are of course not confined to the order. The chapters on TBT and SPS and trade in services, respectively, are remarkably brief (both are shorter than the chapter on the GPA, only 10 pages are devoted to the TBT). This may reflect the personal interest of the authors, but is disappointing given that TBT, SPS and GATS are areas of growing importance not only for practical purposes, but also from the perspective of teaching as they can be used to explain the fundamental principles of world trade law in comparison with the GATT provisions. The last part of the book addresses developing countries in the WTO system (Chap. 19) and a number of "trade and" issues (Chap. 20), such as environment (which receives a remarkably short treatment), culture, labour, human rights and health.

As the subtitle *Text, Materials and Commentary* indicates, the book is a US-style casebook and textbook. It combines excerpts from WTO cases and other material, in particular scholarly articles, with introductions, conclusions and commentaries written by the authors. The selection of the cases used in the book includes the major cases with a few exceptions, such as *Brazil – Retreaded Tyres* and *Mexico – Telecommunications*, possibly something to include in the next edition. The combination of case law, academic material and their own commentaries is certainly one of the major strengths of the book from the perspective of classroom teaching. It allows students and teachers to focus on one text and have the relevant material always at hand. This reduces transaction and real costs. It comes, however, at a price: the material is only presented in excerpts and it may be difficult to appreciate how the solution of a case by a panel or the Appellate Body unfolds. Of course, this presentation of the material does not prevent a teacher from studying a case in its entirety on top of the material presented in the book. The book's function as a classroom book is also supported by a list of questions aimed at testing whether the issues and principles discussed in the relevant chapters have been understood. In line with the Anglo-American tradition of textbooks – and possibly less common for the continental European user – the cases and articles are largely presented without original footnotes. This makes it at times difficult to see arguments of the

dispute settlement institutions in the tradition of the case law or to understand a particular authors argument. Again, here it would be the teacher's responsibility to provide additional, potentially original material.

It should be obvious that not every aspect of the book can be commented on in this short review. Hence, the reviewer will select a few aspects he wishes to discuss, being fully aware of the arbitrariness of this selection. In Chap. 1, "Introduction to World Trade Law", after presenting some basic facts on the scope and structure of global trade, the authors touch upon the contested nature of the policy choices behind trade liberalization. This is a useful endeavour, but the book presents three large excerpts of (neo-)liberal commentators and only one piece with a critical perspective, while openly admitting its sympathy with the former perspectives (p. 29). This in itself is not to be criticized because every author leans towards a particular viewpoint. However, if the authors invite the readers at the end of that chapter (p. 42) to reflect on a number of fundamental issues while working with the book, the bias in the selection of the material presented prior to those questions is unfortunate. In contrast to this, Chap. 6, on dispute settlement, is more nuanced and addresses all pertinent issues in a comprehensive way. This includes the notoriously complicated issue of sequencing (pp. 172–174) as well as the "legitimacy questions" of transparency and amicus curiae briefs (pp. 195–201).

As already mentioned, the chapter on SPS and TBT is remarkably short. It consists mainly of a reformulation of the SPS provisions by the authors (pp. 558–564) and largely uncommented excerpts from *Japan – Apples*, *EC – Hormones* and *Australia – Salmon* (pp. 564–578). The contentious debates about the precautionary principles and the treatment of GMO foodstuffs, including the *EC – Biotech* case, are hardly mentioned, let alone analysed in a comprehensive manner. In the whole section on the TBT, there is no mention of the problem of developing countries' capacity to participate in international standardization organizations. Similarly, the chapter on trade in services leaves out a number of important issues, such as the regulation of financial and telecommunication services and the problems associated with the movement of natural persons (mode 4). Again, in contrast to these chapters, the section on trade and intellectual property is among the stronger chapters of the book. It rightly begins with the observation that the TRIPS is perhaps the most controversial WTO agreement (p. 705). Consequently, the chapter devotes a larger section to criticisms of the agreement (pp. 766–771) and also addresses the TRIPS plus protection in regional trade agreements (pp. 771–775). Only, the most controversial of all issues, the relationship between TRIPS and public health, could have been explained better. It may not be immediately clear to every reader why the TRIPS waiver and the TRIPS amendment were necessary from a legal and health policy perspective (p. 754).

This brief and selective look at some of the chapters reveals light and shadow, which is not surprising for the first issue of a new book. It is therefore hoped that the criticism voiced in this review can contribute to an even better second edition, which the book undoubtedly deserves. Among the stronger parts of the book are its comprehensiveness despite minor shortcomings in some of the chapters. The style of the book is clear and lucid, at times even a bit too colloquial, but students may in

fact enjoy this. Methodologically and theoretically, the book is clearly situated in the mainstream of the academic debate. It is based on legal positivism and driven by an enlightened liberal vision of the world trading order, acknowledging the problems of the current system, but never fundamentally questioning its legitimacy from a justice or fairness perspective. In short, the book is a no-nonsense trade law textbook in the best meaning of the word. The book will therefore find its readership among students who want to get the full picture of world trade law in one go and teachers who want to present their students with the best of two worlds: materials and commentaries. The competitive price of £35 (the book sells for a higher price, US $70, in the USA) will increase the attractiveness of the book. Readers looking for a more critical view of the world trading system or interested in guidance towards further research may find other books more helpful. This, of course, is one of the positive results of an increasing number of WTO law textbooks each with a specific focus. To conclude, Lester and Mercurio's book is a welcome addition to the market of textbooks on world trade law.

Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle, WTO: Trade in Services, Max Planck Commentaries on World Trade Law, Vol. 6

Christoph Ohler

During its short history, the WTO has changed fundamentally the face of international economic law. The strong institutional framework of the WTO as well as the broad capture of trade topics and the corresponding dispute settlement procedure are landmarks for the development of international law, even though a growing number of commentators are hesitant to emphasize the idea of a "new constitutional order" in international trade relations. Despite sobering experiences with the effectiveness and acceptance of the dispute settlement procedure and with the long-lasting standstill in trade negotiations, the WTO will remain the central forum for international trade policy. One of the outstanding agreements in this framework is, no doubt, the General Agreement on Trade in Services (GATS), which is the first international instrument that fully covers all aspects of this economic area. It is, at the same time, a very complex agreement with few fundamental rules which are spelled out in detail in highly technical schedules of specific commitments for each individual member. This technique results in difficult negotiations on trade liberalization measures and also in some legal uncertainties in interpreting and applying the schedules, as can be seen in the famous case *US – Gambling*. The practical difficulties in liberalizing trade in services are not only due to the drafting technique of the GATS but are also due to the complexity of the subject matter itself. This can be explained by the fact that the GATS covers any kind of service in any sector. Therefore, legal solutions have to be found for economic activities as heterogeneous as, e.g. health services, on the one hand, and transport services, on the other hand. Insofar it is not really astonishing that, contrary to the broad ambit of the agreement and its (theoretically) high relevance for many economic sectors, only a few decisions of the Dispute Settlement Body (DSB) concerning the GATS have been adopted so far. The same is true for the limited effects of the agreement on opening markets beyond the degree unilaterally chosen by the members before entering into multilateral negotiations. So the GATS is still an agreement of unfulfilled promises and regulatory possibilities which have not been used by the

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_24, © Springer-Verlag Berlin Heidelberg 2011

members so far. It is against this background that any piece of academic craftsmanship commenting on the legal ambit and effects of the GATS faces the double challenge of technical (over-) complexity and, partly, the lack of normative coherence of the subject matter. But, there is no doubt that *WTO – Trade in Services* can fully cope with this challenge and will set new standards in international research on the GATS.

The three editors of the *Max Planck Commentaries on World Trade Law* are current or former members of the Max Planck Institute for Comparative Public Law and International Law in Heidelberg. The institutional background of the editors (and most of their authors) influences – at least implicitly – their perspective on WTO law as they seek to bind it back in the context of general international law without denying the peculiarities of this area. With a team of 27 authors, nearly all of them internationally acknowledged researchers and practitioners, they published an impressive, in-depth legal analysis of the GATS in the German tradition of an article-by-article commentary. Coherence, specificity and comprehensiveness are the great advantages of this format which – wishfully – should find more acceptance also outside Germany as the editors underline in the preface.

The work opens with an overview of the negotiating history written by Christine Fuchs, followed by an analysis of the preamble (Holger Hestermeyer). Additionally, the book covers the annexes and protocols to the GATS, including the Understanding on Commitments in Financial Services (Armin von Bogdandy and Joseph Windsor) and the Telecom Services Reference Paper (Henry Gao). Each article opens with a helpful bibliography and an overview of case law and official documents. The authors consider the legislative history and the economic rationale of each provision before exploring its content and limits by reference to panel or Appellate Body decisions and academic writing. Insofar, this work will be a benchmark for all further writing in this field and, at the same time, a valuable source of information for academic research and legal practice. It would go far beyond the scope of a book review to appreciate all the articles in this commentary. However, several provisions of the GATS should be taken – pars pro toto – as examples of the high standard which is set by this work.

Diana Zacharias comments on Art. I GATS, the provision dealing with scope and definitions of the agreement. Very difficult questions are raised by the concept of “services supplied in the exercise of governmental authority” (Art. I:3 lit. c), since it is unclear from the wording of the provision when this exemption is met. The definition offered by the agreement is a negative one only when it provides that such services are supplied “neither on a commercial basis nor in competition with one or more service suppliers”. Also the dual standard (no commercial basis/no competition) is extremely vague in itself and therefore open to much speculation. Zacharias analyses these problems step by step by explaining the political background, comparing the provisions with similar rules of EU law and by unfolding the variety of meanings that could be the result of interpretative work. It is, however, not surprising that this textual analysis results in a very differentiated view, whereas it depends on the individual circumstances of each case whether a service is supplied in the exercise of public authority or not. The humble reader is inclined

to ask whether the dilemma of interpreting Art. I:3 lit. b) and c) adequately could only be resolved if the WTO members had actually a broad and common understanding of how to distinguish the sphere of market activities from the sphere of state activities. Actually, the GATS formula is the product of an unclear political compromise which makes the search for interpretative solutions very difficult. It reflects at the same time the fact that many members blur this fundamental distinction in their own legal orders.

Rüdiger Wolfrum then comments on the most favoured nation clause under Art. II GATS. One of the difficult questions in this context is whether services provided in different modes of supply in the meaning of Art. I:2 can be "like" in the sense that there is competition across various modes. Wolfrum seems to deny this question (paragraphs 40, 41) when suggesting that the test for establishing likeness includes that different services are supplied in the same mode. To take one example: Is there direct competition between bank services supplied via the Internet (e.g. payment services) and the same services supplied physically through a branch of a bank? The answer is probably "yes", which shows that the distinctive power of the four modes of supply in legal terms does not necessarily translate into the economic analysis of competitive relationships.

The role of regional integration agreements (RIAs) under Art. V GATS is analysed by Thomas Cottier and Martin Molinuevo. They describe the various conditions that have to be fulfilled before the recognition of a RIA under the GATS and make clear that the interpretation of most of these conditions leaves room for considerable discretion. With respect to Art. V:6 GATS they underline its novel character for the benefit of service suppliers by creating a liberal rule of origin for juridical persons. They argue that this provision also covers branches and representative offices from service suppliers of other members. If this were true, then Art. 54 TFEU (ex-Art. 48 EC) would require a new and much broader understanding in line with the GATS. Insofar, it is noteworthy (what the authors unfortunately do not discuss) that Art. V:6 should in any event be read as excluding the "control theory" for the purpose of such RIAs.

Markus Krajewski deals with the complex issues of "domestic regulation" under Art. VI GATS in a very concise and convincing manner. He stresses the rule-of-law character of Art. VI, qualifying – in accordance with the panel in *US Gambling* – paragraphs 1–3 and 6 as procedural standards and paragraphs 4 and 5 as substantive provisions. With respect to the term "reasonable" in Art. VI:1, he argues that it differs from the more advanced standards of necessity or proportionality. Krajewski explains the negotiation mandate for the Council for Trade in Services under Art. VI:4 GATS, illustrates the limited success of this mandate (so far only the accountancy sector) and analyses thoughtfully the potential for future disciplines. Furthermore, he is the commentator on Art. VII GATS, a provision which is thought to encourage members to make use of this alternative form of trade liberalization. Krajewski asserts that no common definition has been established in trade practice or academic writing. With respect to the GATS this is certainly true. However, it could be worthwhile considering the concept of mutual recognition in customary international law, where a long tradition of academic analysis exists (cf. Ruffert,

Recognition of Foreign Legislative and Administrative Acts, in: Max Planck EPIL, 2007).

A provision of major importance is Art. XIV GATS, dealing with general exceptions. Various strands of legal problems were identified by the academic discussion during the last couple of years, mostly in parallel to Art. XX GATT 1994, such as exclusiveness of legitimate purposes mentioned in Art. XIV GATS, protection of extraterritorial interests, elements and character of the necessity test, and the role of the chapeau. The answers offered by the DSB are not convincing in all respects and neither is the comparison with the jurisprudence of the European Court of Justice (ECJ). Thomas Cottier, Panagiotis Delimatsis and Nicolas Diebold discuss these issues in this commentary. They recognize that the multilateral regulation of trade in services is "in its infancy" in this respect and that it is difficult to anticipate future needs or developments. With respect to interests not covered by the current list of exemptions, they suggest that the WTO judiciary should be required to advance interpretations "adequate to accommodate contemporary concerns" if other "flexibility mechanisms" are not used by the members themselves. The question, how the DSB should go forward in this respect remains, since the limited language of Art. XIV GATS leaves little room for manoeuvre. The case of protecting extraterritorial interests by unilateral measures of the members should be solved, they suggest, by recognizing the concerns protected by peremptory norms of international law (*ius cogens*). However, it goes without saying that any application of the GATS contrary to *ius cogens* would be void. The problem of protecting extraterritorial interests by national regulation rather refers to the problem of international jurisdiction of states which may be exercised to the extent that a sufficient link between the domestic sphere and the international matter can be established. The task under WTO law would then be to integrate this concept which is recognized by customary international law into the system of the agreements. Finally, the necessity test requires further clarification. Applying, however, the test used by the ECJ would not solve all problems, since this test is closely connected with the wide concept of indirect discrimination/restriction under the fundamental freedoms. Insofar, the authors might be slightly too optimistic concerning the exchangeability of legal constructions. In any event, doubts must be raised whether the ECJ actually applies a proportionality test *strictu sensu* (*Angemessenheit* in the meaning of the German doctrine). The ECJ, at least according to its published case law, has never made explicit use of this standard.

The list of positive aspects of this work could be continued. There is no doubt that *WTO – Trade in Services* fills a gap in the legal literature on the GATS. It is a comprehensive source of information and inspiration in many ways. It is desirable that this book will find many interested readers in the academic world and in legal practice.

Part V
Materials

Opinion of Advocate General Kokott Delivered on 26 March 2009[1]

Juliane Kokott

Introduction

1. '*Sisyphus would have done a better job*'.[2] That is only one of many critical remarks concerning the new version of the provisions on the common commercial policy introduced by the Treaty of Nice.[3] Consequently it is no surprise that the extremely complicated wording of the new paragraphs 5 and 6 of Article 133 EC was sooner or later inevitably going to give rise to legal disputes.
2. In the present case the Court is faced with a dispute of that kind.[4] It concerns the accession of Vietnam to the World Trade Organisation (WTO). The Commission of the European Communities and the Council of the European Union are in dispute as to whether approval for Vietnam's accession in the appropriate WTO body fell within the competence of the Community alone or whether the

Case C-13/07 (Case withdrawn)
Commission of the European Communities v
Council of the European Union
(World Trade Organisation (WTO) – Accession of Vietnam – Establishment of the Community position – Choice of correct legal basis – Exclusive or shared competence – Community competence alone or requirement of involvement of the Member States – Article 133(5) and (6) EC in the version of the Treaty of Nice)

[1]Original language: German.

[2]According to Herrmann, Common Commercial Policy after Nice: Sisyphus would have done a better job, CMLRev 39 (2002), p.7.

[3]The Treaty of Nice was signed on 26 February 2001 and came into force on 1 February 2003. It is published in OJ 2001 C 80, p. 1.

[4]In parallel to these proceedings, the Commission has lodged with the Court an application 1/08 for an opinion on the basis of Article 300(6) EC, also relating to the interpretation of Article 133(5) and (6) EC in the version of the Treaty of Nice.

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C. Herrmann and J.P. Terhechte (eds.), *European Yearbook of International Economic Law 2011*, European Yearbook of International Economic Law 2,
DOI 10.1007/978-3-642-14432-5_25, © Springer-Verlag Berlin Heidelberg 2011

involvement of the Member States was required in accordance with Article 133 (6) EC. In fact, the latter path was taken: both the Council as a Community institution and the representatives of the Member States meeting within the Council adopted decisions establishing their respective positions. Approval was then given to the accession of Vietnam to the WTO on behalf of the Community and on behalf of its Member States.

3. The question whether this procedure was correct in law is of considerable practical importance going beyond this particular case. Since the WTO was founded on 1 January 1995 it has already admitted 25 new members, three of which were admitted after the accession of Vietnam, which was completed at the beginning of 2007. At present there are still 29 further applications for accession, including those of Russia and Serbia.[5]
4. Leaving aside such questions of membership within the WTO, the interpretation of Article 133(5) and (6) EC is of considerable importance for the Community's scope for action in negotiations within and outside the WTO, for the scope of the common commercial policy and for the division of powers between the Community and its Member States within this core area of Community activity.

Legal context

Community law

5. Articles 133 EC and 300 EC, which are to be applied in the version of the Treaty of Nice, form the Community-law context of the present dispute.
6. Article 133(1) EC reads as follows:

'The common commercial policy shall be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies'.

7. Paragraphs 5 and 6 of Article 133 EC were recast by the Treaty of Nice and now read as follows:

'(5) Paragraphs 1 to 4 shall also apply to the negotiation and conclusion of agreements in the fields of trade in services and the commercial aspects of intellectual property, in so far as those agreements are not covered by the said paragraphs and without prejudice to paragraph 6.

[5] According to the information published by the WTO itself, which can be consulted on the internet at http://wto.org/english/thewto_e/acc_e.htm (last visited on 3 February 2009).

By way of derogation from paragraph 4, the Council shall act unanimously when negotiating and concluding an agreement in one of the fields referred to in the first subparagraph, where that agreement includes provisions for which unanimity is required for the adoption of internal rules or where it relates to a field in which the Community has not yet exercised the powers conferred upon it by this Treaty by adopting internal rules.

The Council shall act unanimously with respect to the negotiation and conclusion of a horizontal agreement in so far as it also concerns the preceding subparagraph or the second subparagraph of paragraph 6.

This paragraph shall not affect the right of the Member States to maintain and conclude agreements with third countries or international organisations in so far as such agreements comply with Community law and other relevant international agreements.

(6) An agreement may not be concluded by the Council if it includes provisions which would go beyond the Community's internal powers, in particular by leading to harmonisation of the laws or regulations of the Member States in an area for which this Treaty rules out such harmonisation.

In this regard, by way of derogation from the first subparagraph of paragraph 5, agreements relating to trade in cultural and audiovisual services, educational services, and social and human health services, shall fall within the shared competence of the Community and its Member States. Consequently, in addition to a Community decision taken in accordance with the relevant provisions of Article 300, the negotiation of such agreements shall require the common accord of the Member States. Agreements thus negotiated shall be concluded jointly by the Community and the Member States.

The negotiation and conclusion of international agreements in the field of transport shall continue to be governed by the provisions of Title V and Article 300'.

8. Article 300(2) EC, which was also amended by the Treaty of Nice, regulates, inter alia, the procedure for establishing the positions to be adopted in bodies of international organisations:

'Subject to the powers vested in the Commission in this field, the signing, which may be accompanied by a decision on provisional application before entry into force, and the conclusion of the agreements shall be decided on by the Council, acting by a qualified majority on a proposal from the Commission. The Council shall act unanimously when the agreement covers a field for which unanimity is required for the adoption of internal rules and for the agreements referred to in Article 310.

By way of derogation from the rules laid down in paragraph 3, the same procedures shall apply for a decision to suspend the application of an agreement, and for the purpose of establishing the positions to be adopted on behalf of the Community in a body set up by an agreement, when that body is called upon to adopt decisions having legal effects, with the exception of decisions supplementing or amending the institutional framework of the agreement'.

Law of the World Trade Organisation

The WTO Agreement

9. Article II of the Agreement establishing the World Trade Organisation[6] ('the WTO Agreement') defines the scope of the WTO:
   1. 'The WTO shall provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to this Agreement.
   2. The agreements and associated legal instruments included in Annexes 1, 2 and 3 (hereinafter referred to as "Multilateral Trade Agreements") are integral parts of this Agreement, binding on all Members. . . .'.
10. Article XII of the WTO Agreement concerns the accession of new members to the WTO and is worded as follows:
    1. 'Any State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms to be agreed between it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto.
    2. Decisions on accession shall be taken by the Ministerial Conference. The Ministerial Conference shall approve the agreement on the terms of accession by a two-thirds majority of the Members of the WTO'.
11. In accordance with the second sentence of Article IV(2) of the WTO Agreement, in the intervals between meetings of the Ministerial Conference its functions are to be conducted by the WTO General Council.

The GATS

12. The General Agreement on Trade in Services ('the GATS')[7] is a multilateral trade agreement within the meaning of Article II(2) of the WTO Agreement and, in accordance with that provision, is binding on all WTO members.
13. Article II(1) of the GATS contains the following most-favoured-nation clause:

'With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any

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[6]Signed in Marrakech on 15 April 1994 and approved by Council Decision 94/800/EC of 22 December 1994 concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986–1994) (OJ 1994 L 336, p. 1).

[7]OJ 1994 L 336, p. 190.

other Member treatment no less favourable than that it accords to like services and service suppliers of any other country'.

14. Part III of the GATS, containing Articles XVI to XVIII, relates to the so-called *specific commitments* of the members. With regard to market access, Article XVI(1) of the GATS provides as follows:

'With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule'.

15. With regard to national treatment, Article XVII(1) of the GATS contains the following provision:

'In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers'.

16. Finally, under the heading 'Schedules of Specific Commitments', Article XX of the GATS provides as follows:
    1. 'Each Member shall set out in a schedule the specific commitments it undertakes under Part III of this Agreement. . . .
    3. Schedules of specific commitments shall be annexed to this Agreement and shall form an integral part thereof'.

The TRIPS Agreement

17. The Agreement on Trade-Related Aspects of Intellectual Property Rights ('the TRIPS Agreement')[8] is also a multilateral trade agreement within the meaning of Article II(2) of the WTO Agreement and, by virtue of that provision, is binding on all WTO members. Of particular relevance to the present dispute is Article 61 of the TRIPS Agreement, which provides as follows:

'Members shall provide for criminal procedures and penalties to be applied at least in cases of wilful trademark counterfeiting or copyright piracy on a commercial scale. Remedies available shall include imprisonment and/or monetary fines sufficient to provide a deterrent, consistently with the level of penalties applied for crimes of a corresponding gravity. In appropriate cases, remedies available shall also include the seizure, forfeiture and destruction of the infringing goods and of any materials and implements the predominant use of which has been in the commission of the offence. . . .'

[8] OJ 1994 L 336, p. 213.

Background of the dispute

18. The procedure within the Council of the European Union underlying this dispute served the internal Community preparations for Vietnam's accession to the WTO.
19. On 27 October 2006 the Commission submitted to the Council a proposal for a decision establishing the Community position within the General Council of the WTO on the accession of Vietnam to that organisation.[9] In that proposal the Commission indicated as the legal basis Article 133(1) and (5) EC in conjunction with Article 300(2) EC.
20. The Commission's proposal was discussed within the Council. The representatives of the Member States there took the view that the proposal also concerned, inter alia, matters which came under Article 133(6) EC.
21. Subsequently, on 6 November 2006, the Council unanimously adopted a decision establishing the Community's position in the General Council of the World Trade Organisation on the accession of Vietnam to the World Trade Organisation.[10] That position was that the Community, represented by the Commission, would approve Vietnam's accession in the General Council of the WTO. However, the legal basis cited by the Council included Article 133(6) EC, in addition to the provisions already set out in the Commission's proposal. The Council took the view that this was a case of shared competence of the Community and the Member States.
22. On the same day the representatives of the Member States meeting within the Council adopted a common position of the Member States on Vietnam's accession to the WTO and authorised the Commission to adopt that position on behalf of the Member States within the WTO General Council. That position also expressed approval of Vietnam's accession to the WTO.[11]
23. In a statement appended to the Council minutes, the Commission protested against the inclusion of Article 133(6) EC as an additional legal basis for the Council's decision and against the simultaneous decision of the representatives of the Member States meeting within the Council. It also reserved the right to make use of all legal means at its disposal.[12]

[9]Commission proposal of 27 October 2006 for a Council decision establishing the Community position within the General Council of the World Trade Organisation on the accession of the Socialist Republic of Vietnam to the World Trade Organisation (COM(2006) 659 final).

[10]The decision was adopted in the written procedure initiated on 31 October 2006 (Council document CM 3730/06) and ended on 6 November 2006 (Council document CM 3773/06). It was not published in the *Official Journal of the European Union*.

[11]The decision is printed in the same document as the Council decision (see footnote 10).

[12]The statement appended to the Council minutes, which is printed in Council document CM 3773/06, is worded as follows: 'the Commission notes that its proposal had as the legal basis Article 133 (1) and (5) in conjunction with the second subparagraph of Article 300(2). The Council has added paragraph 6 of Article 133 and in addition the Representatives of Member States meeting within the Council have adopted a separate decision approving the accession of Vietnam to the WTO.

24. On 7 November 2006 the WTO General Council resolved, with the approval of the Community and its Member States, both represented by the Commission, to admit Vietnam to the WTO. When Vietnam, for its part, had ratified the accession protocol it became the 150th member of the WTO on 11 January 2007. The details of Vietnam's accession are set out in the accession protocol, which also includes Vietnam's specific commitments.

Procedure before the Court

25. By application of 15 January 2007[13] the Commission brought an action on the basis of Article 230 EC against 'the decision of the Council and the Member States establishing the Community's and the Member States' position within the General Council of the World Trade Organisation on the accession of the Socialist Republic of Vietnam to the World Trade Organisation'.
26. The Commission claims that the Court should:
    - annul that decision;
    - declare that the effects of the annulled decision are definitive; and
    - order the Council to pay the costs.
27. The Council contends that the Court should:
    - dismiss the application as inadmissible in so far as it concerns the decision of the representatives of the Member States meeting within the Council;
    - in any event, dismiss the application as unfounded;
    - in the alternative, and to the extent to which the Court annuls the contested decisions, declare that the effects of those decisions are definitive; and
    - order the applicant to bear the costs.
28. By order of the President of the Court of Justice of 5 June 2007, the Federal Republic of Germany, the Kingdom of Spain, the French Republic, the Republic of Finland and the United Kingdom of Great Britain and Northern Ireland, which had all timeously lodged the appropriate applications (Article 93(3) to (6) of the Rules of Procedure), were granted leave to intervene in support of the Council.
29. In addition, by order of the President of the Court of Justice of 8 June 2008, the Hellenic Republic and, by order of 30 July 2007, the Czech Republic were

The Commission considers that its proposal included the correct legal basis and is of the view that the separate decision of the Representatives of Member States meeting within the Council was not necessary. Consequently the Commission reserves its right to make use of all legal means at its disposal.'

[13] The original application, which was initially submitted by fax, was lodged at the Court Registry on 18 January 2007.

granted leave to intervene in support of the Council pursuant to Article 93(7) of the Rules of Procedure.

30. All of the interveners seek dismissal of the action, with Finland, Spain and the United Kingdom also claiming that the action is inadmissible in so far as it concerns the decision of the representatives of the Member States meeting within the Council.
31. In its observations on the interveners' pleadings, the Council takes issue with the fact that Spain's statement in intervention discloses details of the Council's deliberations, including a legal assessment by the Legal Service of the Council given in the course of those deliberations. I agree with the Council that such information may be subject to the duty of secrecy laid down by Article 6 of the Council's Rules of Procedure, at least for the duration of the current proceedings in this case, and its disclosure may have required prior approval. Consequently, I shall not take that information into account in my Opinion in the present case.[14]
32. The Commission's action was examined by the Court, first, by way of written procedure and, subsequently, on 3 February 2009, in a hearing.

Admissibility of the action

33. According to the wording of its application, the Commission has brought its action against 'the decision'. In its reply it points out in this connection that formally there are two separate decisions, one being the Council's decision on establishing the Community position and the other a corresponding decision by the representatives of the Member States meeting within the Council. However, the Commission claims that the two decisions are inextricably linked with each other so that in fact there is one single decision which as a whole is subject to review by the Court.
34. On that point it must be observed, first of all, that a Community position adopted by the Council under the second subparagraph of Article 300(2) EC may be the subject of an application for annulment under the first paragraph of Article 230 EC because, under Article 230 EC, acts of the Council are open to review by the Court, which has consistently held that an action for annulment must be available in the case of all measures adopted by the institutions, whatever their nature or form, which are intended to have legal effects.[15]

[14]The Court proceeded similarly in its orders in Case C-445/00, *Austria v. Council*, [2002] ECR I, 9151 and in Case C-221/06, *Stadtgemeinde Frohnleiten and Gemeindebetriebe Frohnleiten*, [2007] ECR I, 2613.

[15]See, inter alia, Case 22/70, *Commission v. Council (AETR)*, [1971] ECR 263, paras. 39 and 42; Case 60/81, *IBM v. Commission*, [1981] ECR, 2639, para. 9; and Case C-521/06 P, *Athinaïki Techniki v. Commission*, [2008] ECR I, 5829, para. 42.

35. Furthermore, under the second subparagraph of Article 300(2) EC a decision of the Council is not merely a preparatory act, but the outcome of an opinion-forming process within the Community. Such a decision establishes the Community position finally and with binding effect in the form in which the Commission has to present it later in international bodies.
36. The Commission's action is therefore admissible in so far as it is directed against the Council's decision establishing the Community position.
37. On the other hand, the 'common accord of the Member States' within the meaning of Article 133(6) EC, which in the present case was determined by the representatives of the Member States meeting within the Council, is not an actionable legal act for the purposes of the first paragraph of Article 230 EC. That accord is not an act of the Council, but a joint act of the representatives of the Member States.
38. Contrary to the Commission's argument, the reference to both the Community decision and the accord of the Member States in Article 133(6) EC does not make those two separate legal acts a single *sui generis* legal act which as a whole comes within the jurisdiction of the Court under the first paragraph of Article 230 EC. The wording of Article 133(6) EC itself shows that the two acts exist separately from each other because, 'in addition to' a Community decision, the common accord of the Member States is required.
39. It is true that the Court has held that an act cannot be excluded from its review under Article 230 EC solely because it is described as a decision of the Member States.[16] It is also irrelevant whether the act in question was or was not adopted by an institution pursuant to provisions of the Treaty.[17]
40. In the present case, however, the decision of the representatives of the Member States meeting within the Council cannot, regard being had to its content and all of the circumstances attendant on its adoption, be treated as constituting a disguised decision of the Council. The Council, on the one hand, and the representatives of the Member States, on the other, intentionally adopted two separate decisions, as expressly provided for in Article 133(6) EC. Therefore, having regard to the content of the decision and the circumstances in which it was adopted, the common accord of the Member States is a genuine decision of the representatives of the Member States which cannot be subject to judicial review by the Court.[18]
41. Furthermore, this does not lead to gaps in legal protection because it is still open to the Commission to proceed against the Member States concerned by way of an action for failure to fulfil Treaty obligations (Article 226 EC) if it

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[16] Joined Cases C-181/91 and C-248/91, *Parliament v. Council and Commission* ('Bangladesh'), [1993] ECR I, 3685, para. 14.

[17] Case C-316/91, *Parliament v. Council* ('European Development Fund – EDF'), [1994] ECR I, 625, para. 9.

[18] *Bangladesh* judgment, cited in footnote 16, para. 12.

forms the view that they have encroached on the Community's powers by acting alongside it.

42. The Commission's action is therefore inadmissible in so far as it is directed against the common accord of the Member States.

Merits of the action

43. The Commission's action is based on a single ground of annulment. When establishing the Community position on Vietnam's accession to the WTO, the Council is alleged to have regarded Article 133(6) EC as relevant, which was wrong, and therefore also incorrectly took the view that the Community and the Member States were required to act together. In essence, the Council is charged with failing to make full use of the Community's existing external powers and of unlawfully sharing them with the representatives of the Member States instead of acting alone.

44. This action will be well founded if it transpires that approval of Vietnam's accession to the WTO should have been given by the Community alone, that is to say, to the exclusion of the Member States.

Preliminary observation: requirement of a legal basis in procedural law and also in substantive law

45. In accordance with the principle of limited conferred powers (first paragraph of Article 5 EC), the Community is required to act within the limits of the powers conferred upon it by the EC Treaty and of the objectives assigned to it therein. This principle applies to both internal Community action and action of the Community under international law.[19] In the same way, it follows from the second subparagraph of Article 7(1) EC that the Council can act only within the limits of the powers conferred upon it by the EC Treaty.

46. In respect of *procedural law*, it is common ground that the Community position on the accession of Vietnam to the WTO was correctly established by the Council of the European Union in the form of a decision pursuant to the second subparagraph of Article 300(2) EC. The General Council of the WTO is a body constituted by the WTO Agreement which is required to adopt legally effective decisions on the accession of new members to the WTO (Article XII(2) in conjunction with Article IV(2) of the WTO Agreement).

47. It is likewise undisputed that, in addition to the second subparagraph of Article 300(2) EC, such a decision establishing the Community position also requires a

[19]Opinion 2/94 (ECHR Opinion), [1996] ECR I, 1759, para. 24.

basis in substantive law demonstrating the ambit of Community powers and thereby, ultimately, the scope for Community action marked out by the EC Treaty.[20] All the parties agree that the substantive legal basis is to be found in the provisions concerning the common commercial policy. In this connection, it follows from the relationship with the second subparagraph of Article 300(2) EC that Article 133 EC may be applicable, not only to conventional trade agreements, but also to the Community's voting conduct within the bodies of an international organisation.

48. As the admission of a new WTO member concerns not only the conventional areas of commercial policy, but also trade in services and the commercial aspects of intellectual property,[21] Article 133(1) EC is not sufficient as a legal basis and reference must also be made to the newly amended Article 133(5) EC. For the purpose of the present action it is unnecessary to decide whether the terms 'trade in services' and 'commercial aspects of intellectual property' within the meaning of Article 133(5) EC correspond in every detail to those used in the WTO Agreement because that question is not decisive for the present dispute.
49. The only hotly disputed question in the present case is whether, in addition to paragraphs 1 and 5 of Article 133 EC, paragraph 6 must also apply. It is true that Article 133(6) EC does not, as such, contain a separate *legal basis* for Community action, contrary to what the Council and the Commission appear to presume. However, as it clarifies the limits to the scope of another legal basis, namely Article 133(5) EC, Article 133(6) EC is of considerable importance for determining the respective scopes for action of the Community and the Member States in relation to Vietnam's accession to the WTO.

The Council's argument that it is possible for the Member States voluntarily to act alongside the Council within the framework of Article 133(5) EC

50. The Council takes the view that cooperation between the Community and its Member States in relation to Vietnam's admission to the WTO would have been legally permissible even if the substantive legal basis were provided by Article 133(1) and (5) EC only, and Article 133(6) EC played no part. In fact,

[20] See, to that effect, Joined Cases 3/76, 4/76 and 6/76, *Kramer and Others*, [1976] ECR, 1279, para. 19, according to which 'regard must be had to the whole scheme of Community law no less than to its substantive provisions'; see also Opinion 2/94, cited in footnote 19, paras. 23 et seq.

[21] As is well known, according to Article II(2) of the WTO Agreement, in addition to the 1994 General Agreement on Tariffs and Trade (GATT 1994), there are two further multilateral trade agreements that form part of the WTO Agreement and are thus binding on all WTO members: the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

on the basis of Article 133(5) EC the Member States may also *voluntarily* be involved in Community measures. Therefore, even if Article 133(6) EC were not applicable, the reference to it in connection with the establishment of the Community position would be, at most, a formal error.

51. It is true that the citation of an incorrect legal basis or a reference to an incorrect legal basis in addition to the legal basis that is actually applicable means that the disputed act will be annulled only if the error is more than purely formal, that is to say, an error that could affect the applicable procedure and, thereby, ultimately the content of the legal measure.[22] In the present case, if the reference to Article 133(6) EC were merely a formal error, the Commission's action would have to be dismissed as being unfounded. The ground of annulment put forward by the Commission could then in principle not be successful and would therefore serve no purpose (in French: 'inopérant').[23]
52. However, whether the Council's argument is correct depends on the exact classification of the competence under Article 133(5) EC. This would have to be a non-exclusive Community competence which, in addition, allows the Member States to act in parallel with the Community because the question here in dispute as to the applicability of Article 133(6) EC may be left open only if Article 133(5) EC does indeed allow the Community and the Member States to act together and does not prohibit such cooperation.

Article 133(5) EC does not constitute exclusive Community competence

53. Action by the Member States alongside the Community would in principle be unlawful in the context of Article 133(5) EC if this new Community competence were exclusive, something which the Commission appears to assume as a matter of course.
54. As the Treaties stand at present, there is no comprehensive provision as to which areas of competence of the Community are exclusive and which it shares with the Member States. Of course, the Treaties presuppose the existence of areas of exclusive competence of the Community (second paragraph of Article 5 EC and Article 43(d) EU) and the Court has consistently held that these

[22]Case 165/87, *Commission v. Council*, [1988] ECR, 5545, paras. 18 and 19; Case C-268/94, *Portugal v. Commission*, [1996] ECR I, 6177, para. 79; Case C-491/01, *British American Tobacco (Investments) and Imperial Tobacco*, [2002] ECR I, 11453, para. 98; and Case C-210/03, *Swedish Match*, [2004] ECR I, 11893, para. 44.

[23]On the dismissal of a ground in an action or appeal as being 'to no purpose' or 'of no consequence' ('inopérant'), see Case C-35/92 P, *Parliament v. Frederiksen*, [1993] ECR I, 991, para. 31; Case C-380/03, *Germany v. Parliament and Council*, [2006] ECR I, 11573, para. 125; and Joined Cases C-120/06 P and C-121/06 P, *FIAMM and FIAMM Technologies v. Council and Commission*, [2008] ECR I, 6513, para. 189.

include the common commercial policy in its conventional form as defined in Article 133(1) EC.[24]

55. Nevertheless, exclusive Community competence is the exception and, as a rule, the Community shares its areas of competence with the Member States because only in that way is it possible to ensure that the principle of subsidiarity, a fundamental stipulation of the Treaties which applies only to non-exclusive competence (second paragraph of Article 5 EC), has appropriate scope for application. The increasingly important possibility of enhanced cooperation is likewise not applicable in the areas within which the Community has exclusive competence (Article 43(d) EU).
56. Against that background it by no means necessarily follows that the exclusive nature of the competence under Article 133(1) EC also extends to the new competence under Article 133(5) EC created by the Treaty of Nice. Unlike Article III-315(1) of the Treaty establishing a Constitution for Europe[25] and the future Article 207 of the Treaty on the Functioning of the European Union,[26] the Treaty of Nice did *not* incorporate trade in services and the commercial aspects of intellectual property in the existing legal basis of Article 133(1) EC, but created for them a new, separate legal basis which has numerous special features in substantive and procedural law, as demonstrated by Article 133(5) and (6) EC. In other words, although the provisions on conventional commercial policy in Article 133(1) to (4) EC 'apply', in accordance with the first subparagraph of Article 133(5) EC, to the negotiation and conclusion of agreements in the two new areas specified therein, they do not apply unconditionally.
57. The new competence in Article 133(5) EC could be regarded as being exclusive only if it were clear that the power to negotiate and conclude agreements concerning trade in services and the commercial aspects of intellectual property has been *transferred fully and definitively to the Community* and that the Member States are therefore no longer entitled to exercise any power of their own in those fields,[27] even if the Community itself has not yet taken any

[24]Opinion 1/75 ('local costs'), [1975] ECR, 1355, pp. 1363 and 1364; Case 41/76, *Donckerwolcke and Schou*, [1976] ECR, 1921, para. 32; Opinion 2/91 ('ILO Convention No 170'), [1993] ECR I, 1061, para. 8; Opinion 1/94 ('WTO opinion'), [1994] ECR I, 5267, para. 22 in conjunction with para. 34; Opinion 2/00 ('Cartagena Protocol'), [2001] ECR I, 9713, para. 41; Case C-347/03, *Regione autonoma Friuli-Venezia Giulia and ERSA*, [2005] ECR I, 3785, paras. 75 and 76; and Joined Cases C-402/05 P and C-415/05 P, *Kadi and Al Barakaat International Foundation v. Council and Commission*, [2008] ECR I, 6351, para. 182.

[25]The Treaty establishing a Constitution for Europe ('TCE') was signed in Rome on 29 October 2004 (OJ 2004 C 310, p. 1).

[26]The Treaty on the Functioning of the European Union ('TFEU') is based on amendments to the EC Treaty arising from the Treaty of Lisbon (signed in Lisbon on 13 December 2007) (OJ 2007 C 306, p. 1) and enters into force with that latter Treaty.

[27]Case 804/79, *Commission v. United Kingdom*, [1981] ECR, 1045, paras. 17, 18 and 27.

measures.[28] This means that it is a characteristic of exclusive competence that *only the Community* is entitled to take action.[29]

58. However, that is precisely not the case with regard to Article 133(5) EC, the fourth subparagraph of which makes it clear that the right of the Member States to maintain and conclude agreements with third countries or international organisations is not affected in so far as such agreements comply with Community law and other relevant international agreements. Consequently, the Treaty of Nice did *not* assign competence in that area fully and definitively to the Community.
59. For that reason, the rules on competence contained in Article 133(5) EC lack one characteristic which is crucial for areas of exclusive competence, namely the exclusion of any parallel or concurrent action on the part of the Member States.
60. Admittedly, the Member States may exceptionally also act within the areas of exclusive Community competence if the Community specifically authorises them to do so.[30] However, the fourth subparagraph of Article 133(5) EC cannot be regarded as constituting such authorisation because here the Community is not permitting the Member States to exercise a power which has actually been reserved for itself, but it is the Member States themselves, as 'masters of the Treaties', which in the Treaty of Nice expressly reserved those powers for themselves.
61. Contrary to the Commission's view, the proviso in the fourth subparagraph of Article 133(5) EC also by no means guarantees only the Member States' right to conclude agreements *in other fields* that may have merely marginal points of contact with the common commercial policy, such as double taxation agreements. Nor can the fourth subparagraph of Article 133(5) EC be construed as being a purely transitional provision allowing the Member States to maintain their existing agreements with non-member countries in the area of trade in

[28] *Commission v. United Kingdom*, cited in footnote 27, para. 20.

[29] See, to the same effect, the first half of the sentence in Article I-12(1) TCE and the first half of the sentence in Article 2(1) TFEU, which in that respect may be regarded as codifying the legal position to date; see also the *AETR* judgment, cited in footnote 15, para. 31; Opinion 1/75, cited in footnote 24, pp. 1363 and 1364; and Opinion 2/91, cited in footnote 24, para. 8, which find that there can be no 'concurrent competence' or 'parallel competence' of the Member States alongside exclusive competence of the Community.

[30] *Donckerwolcke and Schou*, cited in footnote 24, para. 32; Case 174/84, *Bulk Oil*, [1986] ECR, 559, para. 31; Case C-70/94, *Werner*, [1995] ECR I, 3189, para. 12; and Case C-83/94, *Leifer and Others*, [1995] ECR I, 3231, para. 13; this case-law has also been incorporated in the respective second halves of the sentences in Article I-12(1) TCE and Article 2(1) TFEU. Apart from the cases of specific authorisation, the Member States may, in the event of inaction on the Community's part, take action in urgent cases as 'trustees of the common interest', but in so doing they must consult the Commission and comply with Community law (*Commission v. United Kingdom*, cited in footnote 27, paras. 22 and 31). In the present case, however, any action by the Member States as 'trustees' in this sense was precluded from the outset because the Council itself adopted a decision in relation to Vietnam's accession to the WTO.

services and the commercial aspects of intellectual property. There is no support at all for such a restrictive interpretation in the wording, meaning, purpose or legislative context of that provision.

62. In truth, although all the additions to Article 133 EC made by the Treaty of Nice serve to assign to the Community new powers in the area of external trade, they serve at the same time to secure for the Member States certain possibilities of action and rights of joint decision within that same area.

63. I must agree with the Commission that exclusive competence for the Community in the field of trade in services and the commercial aspects of intellectual property would be better suited for ensuring the effective representation of European interests at international level. However, no such competence was acquired by the Community under the rules created by Article 133(5) EC. Rather, that step is completed only in the Treaty of Lisbon: Article 207(1) TFEU henceforward expressly places the 'new' fields of commercial policy[31] on the same footing as the conventional fields, and the common commercial policy as a whole is expressly assigned to the exclusive competence of the Union (Article 3(1)(e) TFEU).[32]

64. On the other hand, until the Treaty of Lisbon enters into force, the Community's competence under Article 133(5) EC may only, at most, be converted, as the occasion arises, into exclusive competence in accordance with the so-called *AETR principles*.[33] However, it is not disputed that the Community has not yet acquired by that means a comprehensive exclusive competence for trade in services and the commercial aspects of intellectual property.

65. The Community's competence under Article 133(5) EC is therefore *not* exclusive in nature, at least as Community law stands at present.

66. However, contrary to the view taken by the Council, it does not necessarily follow, from the mere fact that Article 133(5) EC does not provide for exclusive Community competence, that the Member States were automatically entitled to be involved alongside the Community in adopting the decision on Vietnam's accession to the WTO.

Article 133(5) EC creates concurrent, not parallel, competence

67. It would be permissible for the Member States to be involved alongside the Community on the basis of Article 133(5) EC (and without simultaneous recourse to Article 133(6) EC) only if there were *parallel competence* of the

[31]Meaning trade in services, the commercial aspects of intellectual property and foreign direct investments.

[32]Article III-315(1), in conjunction with Article I-13(1)(e), TCE already made similar provision.

[33]*AETR*, cited in footnote 15, paras. 17, 18 and 31; Opinion 1/94, cited in footnote 24, paras. 77 and 95; Case C-467/98, *Commission v. Denmark* ('Open Skies'), [2002] ECR I, 9519, paras. 77 to 84; and Opinion 1/03 ('Lugano Convention'), [2006] ECR I, 1145, paras. 115, 116, 118, 122 to 126.

Community and the Member States in relation to trade in services and the commercial aspects of intellectual property.

68. The existence of such parallel competence might be suggested by a cursory reading of the fourth subparagraph of Article 133(5) EC. The wording of that provision is similar to that of the second paragraph of Article 181 EC, which, in relation to development cooperation, makes it clear that the Community's competence to conclude agreements with third parties does not affect the Member States' competence to negotiate in international bodies and to conclude international agreements.[34] Case-law has construed this as meaning parallel competence, with the result that under the second paragraph of Article 181 EC the Member States are entitled to enter into commitments themselves vis-à-vis non-member countries concerning development cooperation, either collectively or individually, or even jointly with the Community.[35]
69. On closer scrutiny, however, notwithstanding certain similarities in the wording of the fourth paragraph of Article 133(5) EC and the second paragraph of Article 181 EC, there are significant differences owing to the particular characteristics of the respective Community policies. As I shall explain below, those differences militate against applying the case-law on development cooperation to the new areas of Community competence within the framework of the common commercial policy.
70. Thus, in the field of development cooperation, Community policy only complements that of the Member States in that field (Article 177(1) EC).[36] Independent action by the Member States in that field, whether collectively, individually or jointly with the Community, can share out the financial and technical burdens of development cooperation in Europe over several shoulders. Overall, this may result in more intensive development cooperation than would be the case if the Community alone had the right to conclude treaties in this area with non-member countries. Put more simply, the motto of the second paragraph of Article 181 EC and Article 177(1) EC is: the more development aid, the better. It is thus consistent with the meaning and purpose of development cooperation to assume that the Community and the Member States enjoy parallel competence. Of course, the Member States are required to coordinate their policies with the Community when exercising their own powers (Article 180(1) EC) and to respect the priority of Community law.
71. The situation is also similar with regard to antitrust law (Articles 81 EC and 82 EC). The Court has consistently held that Community competition law and national competition law are *applicable in parallel*, since they consider

[34]Similar phraseology is used in Article 111(5) EC (monetary union), the second subparagraph of Article 174(4) EC (environment) and the second subparagraph of Article 181a(3) EC (economic, financial and technical cooperation with non-member countries).

[35]*EDF*, cited in footnote 17, paras. 26 and 34; also similar *Bangladesh*, cited in footnote 16, para. 16.

[36]See also *Portugal v. Council,* cited in footnote 22, para. 36.

restrictive practices from different perspectives.[37] Here again, it is consistent with the meaning and purpose of the relevant rules of the EC Treaty to assume that the Community and the Member States have parallel powers.[38]

72. The situation, however, is different in the field of external trade with which the Court is faced in the present case. The more players there are on the European side at international level, the more difficult it will be to represent effectively the interests of the Community and its Member States outwardly, in particular vis-à-vis significant trading partners. Even if the Commission acts as the joint spokesperson of the Community and the Member States in negotiations, this will be preceded by considerable work on coordination, together with *de facto* pressure for unanimity if, in addition to the Community, all the Member States act individually in dealings involving international law.
73. In addition, there is a risk that individual Member States may, to the detriment of the common interest, obstruct or protract negotiations with non-member countries in order to secure concessions for themselves. Conversely, for non-member countries it may be sufficient, in negotiations 'with Europe', to apply pressure to individual Member States in order circuitously to force concessions from the Community as a whole. Furthermore, the scope for complaints by non-member countries within the framework of the WTO's own dispute-resolution system will increase commensurately with the number of players on the European side which act and enter into commitments at international level.
74. Agreements to which the Member States as well as the Community are parties are consequently out of place in the common commercial policy.[39] They should be permitted only where the Community on its own has no or insufficient power and therefore has to rely on the involvement of its Member States at international level. However, this does not apply with regard to Article 133(5) EC, apart from the cases listed in Article 133(6) EC.
75. For the foregoing reasons Article 133(5) EC should be interpreted as meaning that, within its scope of application, *voluntary* involvement of the Member States alongside the Community is *not* permissible. Rather, to the extent to

[37] Case 14/68, *Walt Wilhelm and Others*, [1969] ECR, 1, paras. 3 and 4; Joined Cases 253/78 and 1/79 to 3/79, *Giry and Guerlain and Others*, [1980] ECR, 2327, para. 15; Case C-137/00, *Milk Marque and National Farmers' Union*, [2003] ECR I, 7975, para. 61; and Joined Cases C-295/04 to C-298/04, *Manfredi and Others*, [2006] ECR I, 6619, para. 38.

[38] For coordination between the Commission and the national competition authorities, and also the priority of Community law, see Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (OJ 2003 L 1, p. 1), particularly Article 3 and recitals 8 and 15 in the preamble.

[39] See, to that effect, Opinion 1/75, cited in footnote 24, pp. 1363 and 1364, according to which the concept of the (conventional) common commercial policy is incompatible with the freedom to which the Member States could lay claim by invoking a concurrent power, so as to ensure that their own interests were separately satisfied in external relations, at the risk of compromising the effective defence of the Community's common interests.

which the Community exercises its own powers under that provision, the Member States may for their part no longer exercise powers in the areas of trade in services and the commercial aspects of intellectual property.

76. In other words, the new powers in respect of external trade conferred upon the Community by Article 133(5) EC are not parallel, but concurrent. A characteristic of *concurrent competence* (also referred to as *shared competence*) is that the Member States exercise their competence in so far as the Community has not exercised its competence.[40] However, if the Community does exercise its competence, it acts *alone*, so far as that competence is sufficient.
77. The presumption that the Community has concurrent competence under Article 133(5) EC is also not precluded by its subparagraph 4, which in fact may be construed simply as an expression of the concurrent nature of the new powers in relation to external trade. Bearing in mind the objective of representation of Community interests at international level which should be as effective as possible, the Member States cannot be allowed, without restriction, to maintain or conclude agreements with non-member countries or international organisations in the fields of trade in services and the commercial aspects of intellectual property, but may do so only in so far as the Community itself does not act.
78. The existence of concurrent competence is also indicated by the fact that the second part of the fourth subparagraph of Article 133(5) EC lays down limits on the Member States' exercise of their own powers if and in so far as the Community has adopted legislation or concluded international agreements. Consequently, agreements maintained or newly concluded by the Member States concerning trade in services or the commercial aspects of intellectual property must be consistent with Community law and other relevant international agreements. In this connection it must be borne in mind that international agreements concluded by the Community form an integral part of the Community legal order[41] and are binding on the Member States (Article 300(7) EC).[42]
79. The point in time from which the Member States can no longer exercise their remaining powers in relation to external trade under the fourth subparagraph of Article 133(5) EC and must give precedence to the Community must be determined having regard in each particular case to the duty of genuine cooperation (Article 10 EC), which requires Member States to facilitate the achievement of the Community's tasks and to abstain from any measure which could jeopardise the attainment of the objectives of the EC Treaty.[43] This duty

[40]See, to that effect, *Kramer*, cited in footnote 20, paras. 39 and 40, and, most recently, the respective second sentences of Article I-12(2) TEC and Article 2(2) TFEU, which may be regarded as codifications of the legal position to date.

[41]Case 181/73, *Haegeman*, [1974] ECR, 449, para. 5; Case 12/86, *Demirel*, [1987] ECR, 3719, para. 7; Case C-459/03, *Commission v. Ireland*, [2006] ECR I, 4635, para. 82; and Case C-431/05, *Merck Genéricos – Productos Farmacêuticos*, [2007] ECR I, 7001, para. 31.

[42]See also Case 104/81, *Kupferberg*, [1982] ECR, 3641, para. 11.

[43]Opinion 2/91, cited in footnote 24, para. 10; *Commission v. Denmark*, cited in footnote 33, para. 110; Case C-266/03, *Commission v. Luxembourg*, [2005] ECR I, 4805, para. 57; Case C-433/03,

of genuine cooperation is of general application and also applies where – as in the present case – the Community does not have exclusive competence and the Member States are thus in principle entitled to enter into conventional obligations towards non-member countries.[44]

80. The adoption of a decision authorising the Commission to act externally on behalf of the Community marks the start of concerted Community action. Such a decision may thus already give rise to a duty on the Member States to refrain from acting in order to facilitate the Community's performance of its task and to ensure the coherence and consistency of the Community action and its representation at international-law level.[45]
81. The coherence and consistency of the Community's international-law representation is endangered particularly in the field of external trade if the Member States act independently alongside the Community at international level without any compelling need for them to do so. The additional involvement of the Member States and the resulting pressure for unanimity weaken the Community's negotiating position vis-à-vis its trading partners.[46]
82. In the present case, on 27 October 2006 the Commission submitted to the Council a proposal for establishing the Community position on Vietnam's application for accession to the WTO, and the Council established a Community position on that basis. From that point in time therefore, at the latest, the Member States were bound by their duty of loyalty under Article 10 EC not to jeopardise the effectiveness of the Community's actions at international level by activities of their own in relation to Vietnam's accession to the WTO, even if that 'only' involved acting in parallel alongside the Community. *The Community alone* was entitled to take measures under Article 133(5) EC from that time onward. Additional action by the Member States alongside the Community was no longer permissible, unless absolutely necessary by virtue of Article 133(6) EC.
83. Contrary to the Council's view, it cannot voluntarily waive some or all of its powers under Article 133(5) EC in favour of the Member States, but must take account of the Community interest in the most effective and coherent representation at international level as is possible and must make full use of its powers to that end. The Council must not allow the powers of the Community and its institutions, as formulated in the EC Treaty, to be distorted.[47]
84. Likewise, the Member States within the Council may not obstruct optimum efficacy of action by the Community in external fields with the object of themselves becoming involved alongside the Community. As already

Commission v. Germany, [2005] ECR I, 6985, para. 63; and Opinion 1/03, cited in footnote 33, para. 119.

[44] *Commission v. Luxembourg*, cited in footnote 43, para. 58, and *Commission v. Germany*, cited in footnote 43, para. 64.

[45] *Commission v. Luxembourg*, cited in footnote 43, paras. 59 and 60, and *Commission v. Germany*, cited in footnote 43, paras. 65 and 66.

[46] See point 72 of this Opinion.

[47] See, to that effect, albeit in a different context, Opinion 1/00, [2002] ECR I, 3493, para. 12.

mentioned, the duty of genuine cooperation (Article 10 EC) requires the Member States to do everything possible to facilitate the exercise of the Community's powers and to abstain from any measure which could jeopardise the attainment of the objectives of the EC Treaty.[48]

Interim conclusion

85. To sum up, it follows from what has been said above that the Community's new external trade competence under Article 133(5) EC is neither exclusive nor parallel in nature. Rather, it is a concurrent competence which allows the Member States to act only in so far as the Community does not exercise its own power. If the Community does exercise its power under Article 133(5) EC, in principle it acts alone unless Article 133(6) EC requires the common accord of the Member States.
86. Against this background, the reference to Article 133(6) EC in the present case was not a purely formal matter, contrary to the view taken by the Council. Rather, the crucial issue here is whether Vietnam's accession to the WTO fell within the scope of that provision or not, because only Article 133(6) EC could justify involvement of the Member States alongside the Community.

The need for involvement of the Member States alongside the Community pursuant to Article 133(6) EC

87. Since action by the Member States in conjunction with the Community was not permissible under Article 133(5) EC, as has just been shown, it needs to be examined in what follows whether it was necessary for the Member States to act alongside the Community pursuant to 133(6) EC.
88. That will be the case if the Community's *own areas of competence* – in this case its exclusive competence under Article 133(1) EC and its concurrent competence under Article 133(5) EC – were not sufficient for approving Vietnam's accession to the WTO, that is to say, its accession touched on certain areas reserved to the Member States. That would then give rise to a *shared competence* of the Community and its Member States within the meaning of Article 133(6) EC, which, in contrast to the normal shared competence,[49] mandatorily requires joint action of the Community and the Member States.[50]

[48]On this point, see once again *Commission v. Luxembourg*, cited in footnote 43, para. 57, and *Commission v. Germany*, cited in footnote 43, para. 63.

[49]On this matter, see point 76 and footnote 40 of this Opinion.

[50]In view of the particular characteristic indicated, it is misleading that in several language versions of the second subparagraph of Article 133(6) EC this form of competence is described

89. Contrary to the assumptions of the Council and Spain, previous Community practice concerning the accession of new WTO members[51] is irrelevant for the purpose of appraising the issue of the applicability of Article 133(6) EC. The Court has consistently held that what is merely Council practice cannot derogate from the rules laid down in the EC Treaty, and also cannot therefore create a precedent binding on the Community institutions with regard to determination of the correct legal basis.[52]
90. Practical difficulties in the negotiation and implementation of mixed agreements or decisions are likewise irrelevant to the question whether Article 133(6) EC was applicable or not in the present case.[53]
91. Whether approval of the admission of a new WTO member comes solely within the scope of Article 133(1) and (5) EC or is also covered by Article 133(6) EC depends entirely on objective factors which are amenable to judicial review, including in particular the aim and content of the legal measure.[54] Consequently, the parties' arguments will be discussed below with reference to the aim and content of the decision establishing the Community position on Vietnam's accession to the WTO.

The relevance of the specific obligations of the Community and Vietnam as a consequence of WTO accession

92. The primary issue in dispute between the parties is how far the specific obligations of the Community and Vietnam as a consequence of the latter's accession to the WTO should be taken into account in the examination of the applicability of Article 133(6) EC.

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by means of the normal term 'shared competence', particularly in the French ('compétence partagée') and English language versions. [Translator's note: the German version of the second subparagraph of Article 133(6) EC uses the more precise term 'gemischte Zuständigkeit', which would translate as 'mixed competence' in English].

[51] Examples given were, in particular, the approval of the Community and the Member States for the accession to the WTO of the Kingdoms of Saudi Arabia and Tonga in 2005, when the EC Treaty, in the version of the Treaty of Nice, likewise governed the issue of approval within the Community.

[52] Case 68/86, *United Kingdom v. Council*, [1988] ECR, 855, para. 24; Case C-84/94, *United Kingdom v. Council*, [1996] ECR I, 5755, para. 19; Case C-414/04, *Parliament v. Council*, [2006] ECR I, 11279, para. 37; Case C-133/06, *Parliament v. Council*, [2008] ECR I, 3189, para. 60; and Opinion 1/94, cited in footnote 24, para. 52.

[53] See, to that effect, Opinion 1/94, cited in footnote 24, para. 107, and Opinion 2/00, cited in footnote 24, para. 41.

[54] Settled case-law: see, by way of example, Case C-300/89, *Commission v. Council* ('titanium dioxide'), [1991] ECR I, 2867, para. 10; *Portugal v. Council*, cited in footnote 22, para. 22; *Kadi and Al Barakaat International Foundation v. Council and Commission*, cited in footnote 24, para. 182; and Opinion 2/00, cited in footnote 24, para. 22.

93. The Commission sees the Community's approval of the accession of a new WTO member as a *general commercial-policy decision* involving only the incorporation of a new State in the structures of an international organisation. Therefore, in the selection of the legal basis for establishing the Community position, guidance may be sought at most in the general fields with which the WTO deals: trade in goods, trade in services, and the commercial aspects of intellectual property rights. On the other hand, the choice of legal basis should not depend on the specific obligations arising for the Community and the new WTO member from the latter's accession; after all, no agreement is being concluded between the Community and the new member.
94. The Commission's view would mean that approval of the accession of a new WTO member would at present fall entirely within the competence of the Community. For the three general areas to which the WTO Agreement relates (trade in goods, trade in services and the commercial aspects of intellectual property rights), the Community has, since the Treaty of Nice, had external competence arising from Article 133(1) EC in conjunction with Article 133(5) EC. To the extent to which new powers have accrued to the Community as a result, it has succeeded to the Member States' functions within the WTO.[55]
95. However, the Council and the interveners supporting it take issue with the Commission. They contend that the specific obligations of the Community and Vietnam are crucial in determining the legal basis which authorises the Community to approve accession to the WTO, and in particular whether recourse in that regard was to be had to Article 133(1) and (5) EC only, or whether Article 133(6) EC should also have been used.
96. The latter view is to be preferred.
97. Admittedly, from the formal viewpoint the accession of a new WTO member is not effected by an agreement between it and the original WTO members, but only by means of an agreement between that new member and the WTO (Article XII(1) of the WTO Agreement).[56] Accordingly, the Community, in giving its approval to such accession, is not concluding an agreement within the meaning of Article 133 EC, but is merely exercising its membership rights within the bodies of that international organisation (second subparagraph of Article 300(2) EC).

[55]A similar situation arose earlier in relation to the GATT 1947 (Joined Cases 21/72 to 24/72, *International Fruit Company and Others*, [1972] ECR, 1219, paras. 14 to 18).

[56]According to the general rules of the law on international treaties, as laid down in the Vienna Convention of 23 May 1969 on the Law of Treaties (UNTS vol. 1155, p.331), international treaties may in principle be amended only by agreement between the parties (Article 39 of the Vienna Convention). There are special rules for the amendment of multilateral treaties (Article 40 of the Vienna Convention). However, these general rules of international law apply only in so far as the treaty in question does not provide otherwise (second sentence of Article 39, Article 40(1) of the Vienna Convention). The WTO members have made use of the latter possibility and have provided for a simplified admission procedure in Article XII of the WTO Agreement which does not require an agreement between all existing WTO members and the new member.

98. This purely formal approach should not, however, distract attention from the actual effects for the Community of the accession of a new WTO member.
99. With the WTO Agreement the members of the World Trade Organisation have equipped themselves not only with a common institutional framework for the conduct of trade relations among themselves (Article II(1) of the WTO Agreement). Rather, several multilateral trade agreements also form an integral part of the WTO Agreement and are binding on all members (Article II(2) of the WTO Agreement).
100. On the basis of these multilateral agreements, membership of the WTO brings with it a large measure of substantive rights and obligations. The agreements are concluded on the basis of reciprocal and mutually advantageous arrangements and aim at an overall balance between rights and obligations.[57] In the field of trade in services, which is of particular interest here, these include a most-favoured-nation clause (Article II(1) of the GATS), but WTO members also enter into specific commitments concerning market access, and such commitments may go as far as treatment equal to that of nationals (Articles XVI and XVII of the GATS).[58]
101. For the Community, any extension to WTO membership automatically leads to a broadening of the geographical scope of the Community's own commitments within the framework of the WTO. So far as trade in services is concerned, for example, the admission of Vietnam to the WTO means that the Community must henceforward grant also to Vietnam most-favoured-nation treatment and that the Community's specific commitments in relation to market access now apply also to service providers and services from Vietnam. Therefore it is not true that the admission of a new member to the WTO does not entail new legal obligations for the Community, as the Commission has argued in the present proceedings.
102. Furthermore, on admission every new WTO member enters into specific commitments with regard to access to its market (Article XX of the GATS), aptly described by some of the parties to these proceedings as amounting to an 'entrance fee'. Such specific commitments on the part of a member acceding to the WTO form an integral part of the GATS and add to the complex weft of rights and obligations of WTO members in relation to each other.
103. Whether and, if so, to what extent a WTO member grants market access, or even national treatment, to foreign services and foreign service providers depends crucially on the specific commitments which it has entered into within the framework of the WTO (Articles XVI and XVII of the GATS).
104. These specific commitments represent commercial-policy concessions by the new WTO member which are normally the subject of lengthy and intensive negotiations within the WTO bodies prior to accession and are recorded in a

[57] See the third recitals in the respective preambles to the WTO Agreement and the GATS; see also Case C-149/96, *Portugal v. Council* ('textile products'), [1999] ECR I, 8395, para. 42.

[58] Similarly Article I(1) GATT and Article 4 TRIPS.

voluminous accession protocol. As the Council observes, every WTO member may take part in these negotiations. In the case of Vietnam, 12 years elapsed between the submission of the application to accede and the actual completion of accession.[59]

105. As France, in particular, correctly points out, in order for the Community to grant its own commercial-policy concessions and to accept such concessions from non-member countries in return, the Community requires a legal basis. This follows from the principle of limited conferred powers (first paragraph of Article 5 EC), which applies to both internal and external Community action.[60] Otherwise, the Community could, for instance, in exchange for the removal of its own customs duties, demand concessions by non-member countries in areas which are outside the scope of its tasks and in respect of which it has no competence, at least as matters stand at present.

106. The general commercial-policy decision to approve the accession of a new WTO member cannot be contemplated separately from the previously negotiated commitments of the respective applicant for accession. In the framework of its political decision-making process the Council of the European Union must necessarily consider whether those commitments are sufficient, from the Community viewpoint, to ensure the overall balance between rights and obligations which it is sought to achieve within the WTO.[61] A new member's 'entrance fee' is an important factor in that connection and the Council must take it into account when exercising its discretion.

107. Contrary to the Commission's view, consideration of the specific obligations of the Community and Vietnam cannot be replaced by a comprehensive examination of the complex multilateral weft of rights and obligations of all WTO members because, when establishing the Community position on the accession of a new WTO member, it is not the entire multilateral system of the WTO that is to be tested, but only the specific changes in the rights and obligations arising for the Community from the admission of the particular applicant for accession.

108. Against that background, the specific obligations of the Community and Vietnam arising from accession to the WTO had to be taken into account in selecting the legal basis for establishing the Community position.

109. In that connection, contrary to what the Commission argues, it is immaterial whether the votes of the Community and its Member States within the General Council of the WTO were decisive for Vietnam's accession or

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[59]Vietnam's application to accede was received by the WTO on 4 January 1995. On 31 January 1995 a working party was set up. On 7 November 2006 the WTO General Council approved Vietnam's accession. On 11 January 2007 Vietnam became a member of the WTO. See again in this regard the information published by the WTO itself at www.wto.org/english/thewto_e/acc_vietnam_e.htm, last visited on 3 February 2009.

[60]Opinion 2/94, cited in footnote 19, para. 24.

[61]See again the third recital in the respective preambles to the WTO Agreement and the GATS, as well as the *textile products* case, cited in footnote 57, para. 42.

whether the necessary majority[62] could have been obtained with the votes of other WTO members. The Community always requires a legal basis for measures which it adopts or in which it is involved. This is so even where it is impossible to predict with certainty whether the objective which the Community seeks to attain (in the present case, influencing the decision of the WTO by particular voting conduct) will be achieved.

The alleged ouster of Article 133(6) EC by other provisions

110. Secondly, the parties are in dispute as to whether Article 133(6) EC can be ousted by other provisions, as alleged by the Commission.

Applicability of Article 133(6) EC even if only marginally concerned

111. First of all, the Commission takes the view that the Community's approval of Vietnam's accession to the WTO concerned Article 133(6) EC only marginally, if at all. However, according to the Commission, that provision is applicable only if the matters listed therein are 'specifically and exclusively' concerned, but not if they are only marginally concerned.
112. It is correct that, with regard to the choice of the legal basis for Community action, the Court has consistently held that a *main-purpose test* must be carried out: if examination of a Community measure reveals that it pursues a twofold purpose or that it has a twofold component, and if one of those is identifiable as the main or predominant purpose or component, whereas the other is merely incidental, the act must have a single legal basis, namely that required by the main or predominant purpose or component.[63]
113. However, this consideration relates to legal measures in respect of which the Community's competence as such is beyond doubt and where it is necessary only to clarify which of several existing areas of Community competence is to be used (*horizontal demarcation of competence*). If, on the other hand, the Community is competent only in respect of certain components of a proposed act, while other components come within the competence of the Member States, (*vertical demarcation of competence*) the Community cannot simply declare that it is competent for the entire act by way of a main-purpose test. Otherwise it would undermine the principle of limited conferred powers

[62]According to Article XII(2) of the WTO Agreement, a two-thirds majority of the members of the WTO is required.

[63]Case C-155/91, *Commission v. Council* ('directive on waste'), [1993] ECR I, 939, paras. 19 and 21; Opinion 2/00, cited in footnote 24, para. 23; Case C-94/03, *Commission v. Council* ('Rotterdam Convention'), [2006] ECR I, 1, para. 35; and Case C-91/05, *Commission v. Council* ('small arms'), [2008] ECR I, 3651, para. 73.

(first paragraph of Article 5 EC; see also the second subparagraph of Article 7(1) EC).[64]

114. Admittedly, the Court has, in recent cases concerning criminal law relating to the environment and marine pollution, recognised that the Community may, as an *annex*, so to speak, to its existing areas of competence, also regulate certain aspects of criminal law if this is necessary in order to ensure that the rules which it lays down are fully effective.[65] However, those cases involved the interpretation of existing Community competence in the areas of the environment and transport.[66] The case-law cited must not be misunderstood as meaning that henceforward, with regard to the division of areas of competence between the Community and the Member States, a simple main-purpose test would be sufficient to create Community competence in areas for which no powers were conferred upon it by the Treaties.
115. However, for the purpose of interpreting areas of Community competence, in no circumstances may a main-purpose test be undertaken or ancillary competence be presumed if that is expressly precluded by provisions of the Treaties. That is the situation here with regard to Article 133(6) EC.
116. The first subparagraph of Article 133(6) EC prohibits the Council – alone[67] – from concluding an international agreement *if it includes provisions* which would go beyond the Community's internal powers.
117. Likewise, the second subparagraph of Article 133(6) EC prescribes shared competence[68] wherever an international agreement relates to trade in the specified services. It is true that the German wording ('im Bereich') and some other language versions[69] could be understood as meaning that the second subparagraph prescribes the conclusion of shared agreements only

[64]Also in Case C-301/06, *Ireland v. Parliament and Council* ('retention of data'), [2009] ECR I, 593, para. 56, the Court distinguishes between the division of areas of competence within the Union, on the one hand, and the division of areas of competence between the Union and the Member States, on the other. The latter embraces the question as to whether the Union has encroached on the Member States' areas of competence.

[65]Case C-176/03, *Commission v. Council* ('criminal law relating to the environment'), [2005] ECR I, 7879, para. 48, and Case C-440/05, *Commission v. Council* ('marine pollution'), [2007] ECR I, 9097, para. 66.

[66]The examples from case-law cited by the Commission, namely Opinion 1/78 ('international agreement on natural rubber'), [1979] ECR, 2871, para. 56, and *Portugal v. Council*, cited in footnote 22, paras. 38 and 39, also relate to the interpretation of existing areas of Community competence under the EC Treaty.

[67]The wording in the first subparagraph of Article 133(6) EC stating that an agreement 'may not be concluded by the Council' is open to misunderstanding. In actual fact, an agreement may not be concluded *by the Community* (that is to say, by the Council as an institution thereof) *alone*.

[68]To distinguish this form of competence from the normal 'shared competence', see point 88 and footnote 50 of this Opinion.

[69]See the Spanish ('en el ámbito'), Czech ('v oblasti'), Greek ('στον τομέα του'), French ('dans le domaine'), Italian ('nei settori'), Portuguese ('no domínio') and Romanian ('în domeniul') versions of the second subparagraph of Article 133(6) EC.

where they relate predominantly or exclusively to trade in the specified services. However, a number of other language versions suggest that the second subparagraph of Article 133(6) EC is to apply if an agreement simply *relates to*[70] the services in question. This broad interpretation is also supported by the regulatory nexus between the second and first subparagraphs (‘in this regard’) and by the general purpose of Article 133(6) EC, which is to safeguard the Member States’ rights of joint decision in areas which are politically sensitive for them, particularly in connection with the WTO.

118. The second subparagraph of Article 133(6) EC would to a large extent cease to be practically effective were its scope confined to sectoral trade agreements (or decisions within the meaning of the second subparagraph of Article 300(2) EC) relating to the service sectors specifically listed therein because, in bilateral and multilateral negotiations in the area of foreign trade (and not least within the framework of the WTO), overall packages are frequently tied up which relate to a large number of different fields, none of which can be said to constitute the predominant component or main subject.

119. Against that background, the requirement for the consensual involvement of the Member States alongside the Community should not be confined to agreements (or decisions) the predominant component or main subject of which falls within the ambit of Article 133(6) EC. Rather, under Article 133(6) EC individual provisions of an agreement may make it necessary to conclude it as a shared agreement, even if those provisions are of secondary importance in relation to the agreement as a whole.

120. Accordingly, Article 133(6) EC is not an exception to the first subparagraph of Article 133(5) EC and, as such, to be interpreted narrowly, but rather a provision which is designed to clarify the precise scope of and the substantive limits to the Commission’s new external trade competence for trade in services and the commercial aspects of intellectual property. At the same time, this provision counteracts a main-purpose test operating to the disadvantage of the areas of competence of the Member States.

121. Individual aspects of an agreement for which the Community has no competence internally ‘infect’ the agreement as a whole and make it dependent on the common accord of the Member States. The picture created by the Commission itself in another context[71] is also absolutely true in relation to Article 133(6) EC. Just as a little drop of pastis can turn a glass of water milky, individual provisions, however secondary, in an international agreement

[70]See the comparatively neutral wording in the Bulgarian (‘отнсно’), Danish (‘om’), Estonian (‘käsitlevad’), English (‘relating to’), Irish (‘a bhaineann le’), Latvian (‘kas saistīıti ar’), Lithuanian (‘susiję’), Hungarian (‘vonatkozó), Maltese (‘li ghandu x’jaqsam ma[’]’), Dutch (‘betreffende’), Polish (‘dotyczące’), Slovak (‘týkajúce sa’), Slovene (‘ki se nanašajo na’), Finnish (‘koskevat’) and Swedish (‘rörande’) versions of the second subparagraph of Article 133(6) EC.

[71]The Commission refers to the requirement of unanimity within the Council for horizontal agreements under the third subparagraph of Article 133(5) EC.

based on the first subparagraph of Article 133(5) EC can make it necessary to conclude a shared agreement.

122. Therefore, the Community on its own, that is to say, without the consensual involvement of the Member States in the form of a shared agreement, can conclude an external trade agreement within the meaning of the first subparagraph of Article 133(5) EC only if that agreement contains *no* provisions which would go beyond the Community's internal powers within the meaning of the first subparagraph of Article 133(6) EC and relates to *none* of the areas listed in the second subparagraph of Article 133(6) EC.

123. In the same way, the Community may act on its own in commercial-policy decisions within bodies of international organisations only if those decisions do not relate to any of the matters referred to in Article 133(6) EC; otherwise, the Community requires the consensual involvement of the Member States when it casts its vote.

124. No doubt this legal position is not exactly conducive to the effective representation of Community interests in the area of external trade, particularly and precisely in the framework of the WTO. However, this disadvantage must be accepted as the Treaties stand at present.[72] The far-reaching rights of joint decision which the Member States reserved for themselves in the Treaty of Nice in relation to the Community's new areas of external trade competence would otherwise be meaningless. In interpreting Treaty provisions, the Court may not exceed the limits on amending the Treaties laid down by Article 48 EU.[73] The first and second subparagraphs of Article 133(6) EC have been removed only by the Treaty of Lisbon, with the result that the Member States' rights of joint decision are now confined to internal Community decision-making, but within the Council unanimity is required in areas which are regarded as being particularly sensitive (second and third subparagraphs of Article 207(4) TFEU).

125. Contrary to the Commission's view, this legal position in the version of the Treaty of Nice does not represent a retreat from the previous position obtaining at the date of the WTO opinion.[74] The first subparagraph of Article 133(5) EC creates a new external Community competence, albeit subject to limitations, for trade in services and the commercial aspects of intellectual property, in respect of which the Community hitherto had no comparable competence. At the same time, that provision expressly leaves untouched the Community's exclusive competence for 'mode 1'[75] services under Article 133(1) EC, which had already been recognised by the Court in the WTO opinion, that is to say,

[72]On the legal position prior to the Treaty of Nice see, to the same effect, Opinion 1/94, cited in footnote 24, para. 107.

[73]See, to the same effect, Opinion 2/94, cited in footnote 19, second sentence of paragraph 35, and Case C-50/00 P, *Unión de Pequeños Agricultores v. Council*, [2002] ECR I, 6677, para. 45.

[74]Opinion 1/94, cited in footnote 24.

[75]'Mode 1' means the supply of a service from the territory of one member of the WTO into the territory of any other member (Article I(2)(a) of the GATS).

services not requiring persons to cross borders.[76] This is made clear by the phrase 'in so far as those agreements are not covered by the said paragraphs'.

Applicability of Article 133(6) EC also to horizontal agreements

126. The Commission further takes the view that Article 133(6) EC is not applicable because the admission of a new member to the WTO is to be treated as equivalent to a horizontal agreement.
127. By emphasizing the horizontal nature of accession to the WTO, the Commission links up smoothly with the abovementioned main-purpose test, according to which Article 133(6) EC applies only if it is 'specifically and exclusively' concerned. I have already shown that such a test in relation to Article 133(6) EC is not permissible.[77]
128. However, the Commission's argument is also based on systemic considerations: for horizontal agreements, the third subparagraph of Article 133(5) EC provides for a uniform legal basis which confers a comprehensive competence upon the Community and takes precedence over Article 133(6) EC.
129. I am not persuaded by that part of the Commission's argument either. It blurs the distinction between procedural rules and substantive provisions in the reformulated paragraphs of Article 133 EC.
130. Contrary to the view taken by the Commission, the Community is provided with a substantive legal basis for negotiating and concluding trade agreements only in Article 133(1) EC and in the first subparagraph of Article 133(5) EC. If those provisions are applied in conjunction with the second subparagraph of Article 300(2) EC, as in the present case, they must be construed as meaning that the Community is allowed, not only to negotiate and conclude *agreements*, but also to participate in the formulation of commercial-policy *decisions* in bodies of international organisations.
131. The substantive limits to the Community's competence under the first subparagraph of Article 133(5) EC are made clear by Article 133(6) EC. If the latter is applicable, the Community needs the involvement of its Member States in the form of a shared agreement or, in the case of decision-making in international bodies, in the form of a common, consensual vote.
132. Moreover, under the fourth subparagraph of Article 133(5) EC the Member States reserve a concurrent competence to maintain and conclude their own agreements within the substantive scope of Article 133(5) EC in so far as such agreements comply with Community law and other relevant international agreements.

[76] In relation to the commercial aspects of intellectual property, the same applies to the prohibition of releasing counterfeit goods for free circulation (Opinion 1/94, cited in footnote 24, paras. 55 and 71).

[77] See points 111 to 125 of this Opinion.

133. The abovementioned substantive-law provisions stand in contrast to the second and third subparagraphs of Article 133(5) EC, which contain purely procedural rules. Those subparagraphs merely state that in certain cases the Council is to act unanimously, although actually a qualified majority would be sufficient to adopt a decision in view of the rule in the first subparagraph of Article 133(5) EC in conjunction with Article 133(4) EC.
134. To be specific, the third subparagraph of Article 133(5) EC, with which the present case is concerned, contains three safeguards. First, the requirement of unanimity – which is still required within the Community in many policy areas that are regarded as being particularly sensitive – is not to be undermined when it comes to the conclusion of horizontal agreements.[78] Second, integration is not to proceed faster in the context of external relations than is the case within the Community, unless that is decided unanimously.[79] And third, where a horizontal agreement takes the form of a shared agreement, the mode of voting within the Council is adjusted to the pressure for unanimity which exists in any case and results from the consensual involvement of all Member States as contracting parties alongside the Community.[80]
135. In view of the very different regulatory content of the third subparagraph of Article 133(5) EC and Article 133(6) EC – the former deals with procedure, the latter with the substantive-law limits of the Community's new external trade competence – it is not possible to infer a rule-exception relationship between them. Rather, Article 133(6) EC also applies to horizontal agreements within the meaning of the third subparagraph of Article 133(5) EC.
136. Contrary to the view espoused by the Commission, there is no uniform substantive legal basis for horizontal agreements in Article 133 EC. Rather, it appears from the systemic link between Article 133(1) and (5) EC that, when concluding horizontal agreements, the Community must, where appropriate, use more than one legal basis simultaneously. If, for example, the WTO Agreement, indubitably the most important existing example of a horizontal agreement, were to be concluded again today, the Community would have to find support at least in Article 133(1) and (5) EC and also, because of the third subparagraph of Article 133(6) EC, in the provisions concerning transport in Title V of the EC Treaty. Even the Treaty of Lisbon

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[78]This applies to horizontal agreements, within the meaning of the third subparagraph of Article 133(5) EC, which relate to the first alternative of the second subparagraph thereof ('where that agreement includes provisions for which unanimity is required for the adoption of internal rules'). See, to the same effect, the second subparagraph of Article 300(2) EC in conjunction with the second sentence of the first subparagraph thereof.

[79]This applies to horizontal agreements, within the meaning of the third subparagraph of Article 133(5) EC, which relate to the second alternative of the second subparagraph thereof ('where it relates to a field in which the Community has not yet exercised the powers conferred upon it by this Treaty by adopting internal rules').

[80]Horizontal agreement that 'also concerns . . . the second subparagraph of paragraph 6'.

will not provide the Community with a uniform and comprehensive external trade competence for horizontal agreements because, for the field of transport, Article 207(5) TFEU still requires recourse to the provisions of the common transport policy.

Interim conclusion

137. It follows from the foregoing that Article 133(6) EC is applicable even where it is not predominantly concerned. For the application of Article 133(6) EC, it is also irrelevant whether the agreement or decision in question is horizontal in nature.

The requirements of Article 133(6) EC in detail

138. Finally, the parties are in dispute as to whether the specific obligations of the Community and Vietnam as a result of accession to the WTO were such in the present case as to require the involvement of the Member States under Article 133(6) EC.

Involvement of the Member States under the first subparagraph of Article 133(6) EC

139. It follows from the first subparagraph of Article 133(6) EC that the Community cannot – alone[81] – conclude an agreement if it includes provisions which would go beyond the Community's internal powers. In the same way, the Community cannot act alone in relation to commercial-policy decisions within bodies of international organisations under the conditions of the first subparagraph of Article 133(6) EC if the subject-matter of those decisions goes beyond the Community's internal powers.
140. First of all, it must be made clear that the scope of that provision is by no means limited to such agreements (or decisions) as include provisions that would lead to harmonisation of national law where the EC Treaty rules out harmonisation. As shown by the words 'in particular', the prohibitions of harmonisation laid down in the EC Treaty are only *examples* of the application of the first subparagraph of Article 133(6) EC and do not restrict the scope of the provision to that field.
141. Furthermore, the half-sentence in the first subparagraph of Article 133(6) EC beginning with the words 'in particular' must also not be understood as meaning that the prohibition on exceeding the Community's internal powers

[81] See on this point, once again, footnote 67.

applies only where it would be particularly serious to do so, as for example in the case of harmonisation prohibited by the EC Treaty. Such an interpretation would be tantamount to the introduction of an unwritten *de minimis* threshold. This would be incompatible with the principle of limited conferred powers (first paragraph of Article 5 EC), which also applies unconditionally to external powers.[82] The Community may not generally exceed the bounds of its competence, regardless of whether any such excess is a minor matter or more serious.

142. The meaning and purpose of the first subparagraph of Article 133(6) EC is, very generally, to put the Community's internal and external powers on a parallel footing and to prevent the Community from entering into external commitments to which it would be unable to give effect internally for want of sufficient powers.

143. In essence the Council gives two examples which, in its opinion, demonstrate that the approval of Vietnam's accession to the WTO exceeded the Community's internal competence, which is why it was necessary for the Member States to be involved alongside the Community under the first subparagraph of Article 133(6) EC.

Restrictions on access to the market for services

144. The Council's first example relates to the specific commitments of the Community and Vietnam in the context of Articles XVI and XVII of the GATS relating to access to the market for services and service providers. Certain Member States have in this connection provided for, inter alia, restrictions on access to the market for 'mode 3' hospital services,[83] which include in particular approval requirements in the framework of national health-care systems[84] and in some cases also a needs test.[85] In addition, natural persons are subject to numerous restrictions on access to the market for providing 'mode 4' services,[86] such as an economic needs test, as well as residence or nationality requirements.

[82] Opinion 2/94, cited in footnote 19, para. 24.

[83] 'Mode 3' means the supply of a service by a service supplier of one member through a commercial presence in the territory of any other WTO member (Article I(2)(c) of the GATS). [Translator's note: the remainder of the footnote is not relevant to the English text].

[84] In English 'health plans' or 'health-service plans'.

[85] The Council refers specifically to the examples of Belgium (where the needs test relates to 'the needs in function of the population, age scale, death rate and geographical spread') and Austria ('due consideration on a case-by-case basis is taken of the density of population, existing facilities, traffic infrastructure, topographical conditions and the distance between hospitals').

[86] 'Mode 4' means the supply of a service by a service supplier of one member through the presence of natural persons of a member in the territory of any other WTO member (Article I(2)(d) of the GATS). [Translator's note: the remainder of this footnote is not relevant to the English text].

145. The Council doubts whether the Community has, on the basis of the EC Treaty, internal powers in respect of those restrictions.
146. First of all, it must be observed in this connection that, since the Treaty of Amsterdam, the Community has acquired several new powers for regulating the entry and residence of natural persons from non-member countries. These powers are contained in Title IV of the EC Treaty and entitle the Community to adopt not only rules on visas for intended stays of no more than three months (Article 62(2)(b) EC) and measures on immigration policy (Article 63(3)(a) EC), but also rules on the freedom of movement within the Community of nationals of non-member countries (Article 63(4) EC).
147. Apart from these entry and residence matters, provisions concerning the taking-up and pursuit, by natural and legal persons, of activities as self-employed persons within the Community, including in the health sector, fall within the scope of the provisions on the internal market.
148. There the Community has power not only to issue directives for the mutual recognition of diplomas, certificates and other evidence of formal qualifications (Article 47(1) EC), but also power to issue directives for giving effect to the freedom of establishment (Article 44 EC) and for the coordination of the provisions laid down by law, regulation or administrative action in Member States concerning the taking-up and pursuit of activities as self-employed persons (Article 47(2) EC).[87] In addition, the Community may issue directives for the coordination of provisions for special treatment of foreign nationals on grounds of public policy, public security or public health (Article 46(2) EC).
149. As the Court found in the WTO opinion, the sole and express objective of those provisions is to secure the right of establishment and freedom to provide services for nationals of Member States.[88] However, that does not mean that 'the Community institutions are prohibited from using the powers conferred on them in that field in order to specify the treatment which is to be accorded to nationals of non-member countries'.[89] Therefore the Community may, when issuing directives for completing the internal market, at least *join in regulating* how nationals of non-member countries working in the Community are to be treated if that is necessary, for example, for bringing about equal conditions of competition within the internal market. The fact that those powers have not been fully used and have therefore not yet been transformed into *exclusive* areas of competence within the meaning of the *AETR* judgment, but continue to be of a *concurrent* nature,[90] is not relevant to the question of

[87]These powers apply to the freedom to provide services (Article 55 EC), as well as the freedom of establishment, and cover legal as well as natural persons (Article 48 EC).

[88]Opinion 1/94, cited in footnote 24, paras. 81 and 86.

[89]Opinion 1/94, cited in footnote 24, para. 90. In that opinion, the Court adds (paras. 90 et seq.) that numerous Community acts adopted on the basis of Articles 44 EC and 47 EC already exist which also apply to nationals of non-member countries.

[90]Opinion 1/94, cited in footnote 24, paras. 95 to 98.

the *existence* of internal Community powers, which is the only issue of interest in the context of the first subparagraph of Article 133(6) EC.

150. Specifically in the health sector, however, certain limits have been imposed on the Community's powers. In particular, in the field of health policy, the Community must fully respect the responsibilities of the Member States for the organisation and delivery of health services and medical care (Article 152(5) EC). In any event, the needs test mentioned by the Council, which is required in some countries for the authorisation of new hospitals, is closely connected with the organisation of the respective national health services and therefore falls within the specific competence of the Member States.[91]

151. Consequently the Community has no internal power within the meaning of the first subparagraph of Article 133(6) EC in relation, at least, to some of the market-access rules applying to hospital services, with the result that the involvement of the Member States, alongside the Community, was necessary on the occasion of Vietnam's accession to the WTO.

Article 61 of the TRIPS Agreement

152. The Council's second example relates to Article 61 of the TRIPS Agreement. The Council alleges that the commitments arising from that provision would lead to the harmonisation of national criminal law concerning the infringement of certain intellectual property rights, in respect of which the Community has no power.

153. It is true that, as matters stand at present, criminal law and the legal rules governing criminal procedure do not in principle come within the competence of the Community and it has no general power with regard to the harmonisation of national law in that field.[92] However, as I have already stated, the Court has found, in its judgments on criminal law relating to the environment and marine pollution, that the Community may join in the regulation of certain aspects of criminal law if this is necessary in order to ensure that the rules which it lays down are fully effective.[93] I think that it is not altogether impossible that the Community legislature could find support in that case-law if it creates European intellectual property rights which are fortified with

[91]This is also not refuted by Case C-169/07, *Hartlauer*, [2009] ECR I, 1721, which relates to a *national provision* concerning the needs test for the purpose of authorising clinics. The provision in question is examined by reference to the freedom of establishment (Article 43 EC). On the other hand, no mention is made of a *Community* power to require such a needs test to be carried out by the Member States, or of a power to harmonise national legislation in that connection.

[92]Case 203/80, *Casati*, [1981] ECR, 2595, para. 27; Case 186/87, *Cowan*, [1989] ECR, 195, para. 19; *criminal law relating to the environment*, cited in footnote 65, para. 47; and *marine pollution*, cited in footnote 65, paragraph. 66.

[93]*Criminal law relating to the environment*, cited in footnote 65, para. 48, and *marine pollution*, cited in footnote 65, para. 66.

penalties[94] or if it adds to existing rules[95] in order to ensure that they are fully effective by means of a criminal-law element.[96] Article 61 of the TRIPS Agreement is one provision which shows that a safeguard of that kind is regarded internationally as being necessary.

154. However, in its *marine pollution* judgment the Court expressly stated that the determination of the type and level of the criminal penalties to be applied does not fall within the Community's sphere of competence, thus leaving it to the Member States.[97] Consequently, as matters stand at present, the Community has no power to adopt a *comprehensive criminal provision*.[98]

155. Article 61 of the TRIPS Agreement certainly does not lay down a specific level of penalty for WTO members, but it does require them to introduce certain types of penalty, namely imprisonment and/or monetary fines and also, in appropriate cases, the seizure, forfeiture and destruction of items. Consequently, as Community law stands at present, the requirements of Article 61 of the TRIPS Agreement go beyond the Community's internal powers.

156. As the first subparagraph of Article 133(6) EC requires the internal and external powers of the Community to be parallel, the Community was not entitled to approve, on its own, Vietnam's accession in so far as it relates to Article 61 of the TRIPS Agreement. For that reason Vietnam's accession to the WTO thus required the involvement of the Member States alongside the Community.

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[94]For example, there are plans to create a Community patent: see the Commission's proposal for a regulation of the Council on the Community patent, COM(2000) 412 final (OJ 2000 C 337 E, p. 278). At present Article 308 EC is used as the legal basis for the creation of such intellectual property rights (see also Opinion 1/94, cited in footnote 24, para. 59). When the Treaty of Lisbon enters into force the Union will have in Article 118 TFEU an express power to create European rules on uniform protection of intellectual property rights. Further, under the conditions set out in Article 83(2) TFEU it will acquire express competence to establish minimum conditions for determining offences and penalties.

[95]See, for example, Council Regulation No 40/94 of 20 December 1993 on the Community trade mark (OJ 1994 L 11, p. 1) and Council Regulation (EC) No 6/2002 of 12 December 2001 on Community designs (OJ 2002 L 3, p. 1).

[96]See in this connection also the amended proposal for a directive of the European Parliament and of the Council on criminal measures aimed at ensuring the enforcement of intellectual property rights (COM(2006) 168 final), which is based on Article 95 EC in conjunction with the judgment on the *criminal law relating to the environment*.

[97]Cited in footnote 65, para. 70.

[98]When the Treaty of Lisbon enters into force the Union will acquire, under the conditions laid down in Article 83(2) TFEU, the power to establish minimum conditions for determining offences and penalties.

Involvement of the Member States under the second subparagraph of Article 133(6) EC

157. The second subparagraph of Article 133(6) EC provides that, by way of derogation from the first subparagraph of paragraph 5, agreements relating to trade in cultural and audiovisual services, educational services, and social and human health services, fall within the shared competence of the Community and its Member States. In the same way, under the conditions set out in the second subparagraph of Article 133(6) EC, the Community may not be involved on its own in commercial-policy decisions in bodies of international organisations within the meaning of the second subparagraph of Article 300(2) EC.
158. In the Commission's view, the second subparagraph of Article 133(6) EC concerns only cases in which the conclusion of an agreement by the Community would lead to harmonisation of the law of the Member States in the areas of culture, audiovisual services, education, social or health services. This, it argues, follows from the regulatory nexus between the first and second subparagraphs of Article 133(6) EC. As shown by the words 'in this regard', the second subparagraph addresses in more detail the provisions set out in the first subparagraph. The purpose of both subparagraphs is merely to prevent the Community, when it exercises its external powers, from undermining the prohibitions of harmonisation which are laid down at various points in the Treaty; to that extent, the second subparagraph of Article 133(6) EC reflects Articles 149 EC to 152 EC.
159. I am not persuaded by that argument.
160. Under the second subparagraph of Article 133(6) EC, the consensual involvement of the Member States alongside the Community is required as soon as and in so far as the areas listed therein are affected, irrespective of whether the trade agreement concerned leads to harmonisation of national law or not.
161. If the scope of the first subparagraph of Article 133(6) EC cannot be reduced only to cases of harmonisation of national law, as already mentioned,[99] even less can that interpretation be transposed to the second subparagraph by means of the words 'in this regard'.
162. Furthermore, the first and second subparagraphs of Article 133(6) EC are independent of each other[100] and one does not take precedence over the other. In particular, the second subparagraph cannot be regarded merely as addressing in more detail the provisions of the first. They do not both cover the same field; indeed, each subparagraph has its own scope and regulatory content.

[99] See point 140 above.

[100] This is shown by the general structure as indicated by a neighbouring provision: the third subparagraph of Article 133(5) EC refers only to the second subparagraph of paragraph 6, but not to the first.

163. On the one hand, the scope of the second subparagraph exceeds that of the first. The second extends the requirement for the common accord of the Member States to areas for which the Community has power to harmonise national law and which therefore are not covered by the first subparagraph at all. This applies, for example, in the case of audiovisual services, for which an internal power of harmonisation exists[101] and has already been exercised with the 'television without frontiers' directive.[102]
164. On the other hand, the scope of the second subparagraph is less than that of the first because it does not in any way list all the areas in which the Community would have no internal power within the meaning of the first subparagraph or in which harmonisation would be prohibited within the Community. The list in the second subparagraph does not, for instance, include criminal law and the legal rules governing criminal procedure, in respect of which, as the Treaties stand at present, the Community has in principle no competence,[103] or employment policy, where the Community is prohibited from harmonising national law (second paragraph of Article 129 EC) in any way.
165. Furthermore, it cannot be inferred from the words 'in this regard' that the *scope* of the two subparagraphs is identical. Those words are intended only to make it clear that the first and second subparagraphs of Article 133(6) EC have the same *legal consequence*: all the matters to which they relate are included among those in respect of which the Council alone cannot conclude agreements on the Community's behalf. The purpose is to ensure that the respective agreements are concluded in the form of shared agreements, that is to say, with the Member States joining in as contracting parties alongside the Community.
166. By contrast, the need for shared agreements to be concluded arises from very different considerations in the two subparagraphs. Whereas the first subparagraph of Article 133(6) EC seeks to make the Community's internal and external powers parallel, as has already been mentioned,[104] the Member States' insistence on shared agreements in the second subparagraph can be explained by the politically sensitive nature of the areas which it lists.[105] For agreements on services affecting the areas listed in the second subparagraph of Article 133(6) EC, the Member States are to be granted not only a

[101]Articles 47(2) EC and 55 EC (previously Articles 57(2) and 66 of the EC Treaty).

[102]Council Directive 89/552/EEC of 3 October 1989 on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities (OJ 1989 L 298, p. 23), last amended by Directive 2007/65/EC (OJ 2007 L 332, p. 27).

[103]See in this regard the cases cited in footnote 92.

[104]See point 142 above.

[105]As an example of the importance of audiovisual services for the cultural diversity and the language policy of the EU Member States, see, most recently, Case C-222/07, *UTECA*, [2009] ECR I, 1407, and my Opinion in that case, in particular points 90 to 102.

right of veto internally within the Council,[106] but are also to retain a comprehensive right of joint decision externally at international level.

167. In the present case this means that, for Vietnam's accession to the WTO, the Member States were required to be involved alongside the Community simply if that accession affected one or more of the areas specified in the second subparagraph of Article 133(6) EC, regardless of whether or not that led to the harmonisation of national laws or regulations within the meaning of the first subparagraph. As already mentioned,[107] account must be taken in this regard of the specific commitments of the Community and Vietnam resulting from WTO accession.

168. It is common ground that a number of the Community's specific commitments within the framework of the GATS relate to services in the areas of culture, social and health services and education, and that their geographical scope is extended to Vietnam as a result of the latter's accession to the WTO. Vietnam has likewise, by virtue of its accession to the WTO, entered into specific commitments within the framework of the GATS relating to audiovisual services, education, health services, and social and cultural services.

169. It follows that the Community's approval of Vietnam's accession to the WTO related to several of the areas mentioned in the second subparagraph of Article 133(6) EC. Consequently, the Community was not entitled on its own, in the WTO General Council, to approve Vietnam's admission and it needed the Member States to be involved for that purpose in the form of concerted voting conduct.

Interim conclusion

170. As the Community was not entitled on its own to approve Vietnam's accession to the WTO, but required concerted involvement of the Member States pursuant to Article 133(6) EC, the Commission's action must be dismissed as being unfounded, in so far as it is admissible at all.

Limitation of the effects of possible annulment

171. Should the Court, contrary to the foregoing observations, annul the contested decision, it would be appropriate to limit the effects of the judgment. This position has also been taken by the parties and they agree in asking the Court to uphold the effects of the contested decision, if necessary.

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[106]This right of veto arises from the requirements of unanimity contained in the second and third subparas. of Article 133(5) EC.

[107]See points 92 to 109 above.

172. Under the second paragraph of Article 231 EC, the Court may, if it considers this necessary, state which of the effects of the legal measure which it has declared void are to be considered as definitive. Although, strictly speaking, this provision relates, as is apparent from its wording, only to regulations, the Court has applied it by analogy to decisions.[108]

173. In the present case, justification for the contested decision to continue to have effect lies in the fact that Vietnam has already become a member of the WTO. The annulment of a prior decision establishing the Community position would not alter the fact that Vietnam's accession to the WTO is binding under international law on the Community and its Member States because infringements of provisions of internal law cannot in principle, according to the general rules of international law, have any bearing on the competence to conclude treaties and agreements.[109] Within the Community, however, uncertainty might arise as to the legal position regarding the effects of Vietnam's accession to the WTO and with regard to trade with that non-member country. To avoid any legal uncertainty concerning the rules applying to trade with Vietnam, therefore, it is necessary that the effects of the contested decision be maintained.[110]

174. Unlike the situation in Case C-178/03,[111] however, in the present case it would be pointless to require the Council to adopt another decision within a reasonable period, but without recourse to Article 133(6) EC, because so far as the future is concerned there is no longer any need to establish a Community position on Vietnam's accession to the WTO. The establishment of that Community position was meaningful only with a view to the Community's voting conduct within the WTO General Council on 7 November 2006. That vote has already taken place and will not be repeated.

Costs

175. Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. As the Commission has failed entirely in its submissions, it must be ordered to pay the costs in accordance with the Council's application.

[108] Case C-22/96, *Parliament v. Council*, [1998] ECR I, 3231, para. 42, and Case C-155/07, *Parliament v. Council* ('guarantees'), [2008] ECR I, 8103, para. 87.

[109] See, to the same effect, Article 46 of the Vienna Convention on the Law of Treaties.

[110] See, to that effect, Case C-360/93, *Parliament v. Council*, [1996] ECR I, 1195, paras. 33 to 36; Case C-159/96, *Portugal v. Commission*, [1998] ECR I, 7379, paras. 52 and 53; Case C-178/03, *Commission v. Parliament and Council* ('dangerous chemicals'), [2006] ECR I, 107, paras. 64 and 65; and *guarantees* judgment, cited in footnote 108, paras. 87 and 88.

[111] *Dangerous chemicals* judgment, cited in footnote 110, para. 65.

176. By way of exception to the foregoing, it follows from Article 69(4) of the Rules of Procedure that the Member States which intervened in the proceedings must bear their own costs.

Conclusion

177. On the basis of the foregoing considerations, I propose that the Court:
    (1) Dismiss the action as inadmissible in so far as it is directed against the decision of the representatives of the Member States meeting within the Council, otherwise dismiss the action as unfounded;
    (2) Order the Czech Republic, the Federal Republic of Germany, the Hellenic Republic, the Kingdom of Spain, the French Republic, the Republic of Finland and the United Kingdom of Great Britain and Northern Ireland each to pay their own costs, otherwise order the Commission of the European Communities to pay the costs of the proceedings.