Introduction to the Laws of Kurdistan, Iraq
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Preface to the Series: Introduction to the Laws of Iraq and Iraqi Kurdistan

Iraq and Iraq's Kurdistan Region is at a compelling juncture in their histories. In the wake of the transition to a democratic state, the country and region economy has prospered and its institutions have grown more complex. As institutional capacity has grown, so too has the need for a robust rule of law. An established rule of law can provide assurances to investors and businesses, while keeping checks on government and private powers and protecting citizens’ fundamental rights. Institutions of higher learning, such as universities and professional training centers, can and should play a key role in stimulating and sustaining this dynamic. Indeed, education is foundational.

This paper is part of the Introduction to the Laws of Iraq and Iraqi Kurdistan, a series of working papers produced by the Iraqi Legal Education Initiative (ILEI) of Stanford Law School. This series seeks to engage Iraqi students and practitioners in thinking critically about the laws and legal institutions of Iraq and Iraqi Kurdistan. Founded in 2012, ILEI is a partnership between the American University of Iraq in Sulaimani (AUIS) and Stanford Law School (SLS). The project seeks to positively contribute to the development of legal education and training in Iraq.

The working paper series devotes significant attention to pedagogy. By writing in clear and concise prose and consulting with local experts at each step of the writing process, the authors strive to make the texts accessible to diverse and important constituencies: undergraduate law students, lawyers and judges, government officials, members of civil society, and the international community. By discussing the Iraqi and Kurdish legal regimes and applying specific laws to factual situations, the authors model how to “think like a lawyer” for the reader. They also use hypothetical legal situations, discussion questions, and current events to stimulate critical thinking and encourage active engagement with the material.

These working papers represent the dedicated efforts of many individuals. Stanford Law School students authored the texts and subjected each working paper to an extensive editing process. The primary authors for the initial series including papers on Commercial Law, Constitutional Law, and Oil and Gas Law, were John Butler, Mark Feldman, David Lazarus, Ryan Harper, and Neil Sawhney under the guidance of the Rule of Law Program Executive Director, Megan Karsh. Jessica Dragonetti, Emily Zhang, and Jen Binger authored the remaining papers on domestic law. Kara McBride, Cary McClelland, Neel Lalchandani, Charles Buker, Liz Miller, Brendan Ballou, and Enrique Molina authored papers primarily concerned with Iraq’s engagement with international law. I also thank the former and current deans of Stanford Law School, Deans Larry Kramer and Liz Magill, for their financial support, and the Stanford Law School alum, Eli Sugarman (J.D., 2009), who acts as an advisor to the project.

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ILEI plans to continue publishing working papers. All texts will be published without copyright and available for free download on the internet.

To the students, educators, legal, and government professionals that use this set of working papers, we sincerely hope that it sparks study and debate about the future of Iraqi Kurdistan and the vital role magistrates, prosecutors, public defenders, private lawyers, and government officials will play in shaping the country’s future.

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1 INTRODUCTION

Before we dive into the fascinating subject of international trade, let us take a moment to think about what international trade is and how it affects us. On an ordinary day, you may wear jeans produced in Turkey, ride on a bus produced in Germany, and communicate with your friends on cellular phones designed in the United States, but manufactured in China. Now answer the following question: how did all of these goods (items or materials produced, consumed, and traded in an economy) find their way into your city? If you guessed international trade, then you are correct. Many of the goods and services (intangible goods such as banking services, cellular phone service, etc.) we use on a daily basis are acquired through trade with different countries. Like any other economic activity, the trade of goods and services is governed by a set of rules and regulations. However, international trade is also governed by international organizations and international agreements. The purpose of this chapter is to introduce you to the rules and regulations that govern the international trade of goods and services, as well as to the organizations in charge of making and enforcing said rules.

To begin, we will briefly look at the rationales in favor of the liberalization of international trade, as well as the arguments against it. For now, we will define liberalization as the progressive reduction of barriers to trade. We will then learn about the history of the current international trade system, followed by an overview of the treaties—deals and agreements between countries—and organizations that govern international trade. After being exposed to the basic structures upon which the current international trade regime is built, we will explore the rules and principles of international trade, as well as their exceptions and remedies. The chapter will end with a discussion of the interaction between international trade and international investment. You should know that although we will discuss the international trade in services, the chapter’s main focus is international trade in goods.

After reading this chapter, you will be familiar with the core principles of international trade law, and how they are applied to the international trade of goods and services. Additionally, you will be acquainted with the organizations and agreements that oversee international trade. Most importantly, however, you will have a better appreciation of how deeply integrated the world has become, and the ways in which international trade has made this happen.

2 WHAT IS INTERNATIONAL TRADE AND WHY DO STATES ENGAGE IN IT?

As we discussed in the previous section, international trade is the sale and purchase of goods and services across international borders. International trade is governed by a vast set of rules,
codified in treaties and trade agreements. To clarify, the rules we are referring to are those governing the actions of states and governments with regard to international trade. We will not be discussing international investment law, and will also not be discussing commercial or investor-state arbitration.

Now that we have a basic definition of international trade, perhaps we should begin to answer the question of “why do states trade?” The answer, again, is rather simple. We buy goods and services from other countries because we cannot domestically produce all the goods and services that each individual consumer wants and needs. The reason for this is that each country has different factors of production. Factors of production are the resources used to build an economy and produce goods and services; they are land, labor, and capital. Each country is endowed with different combinations of these factors, and therefore each country is capable of producing different combinations of goods and services. When domestic production is greater than domestic demand for a good, excess production is traded on the international market. The act of selling domestically produced goods to international consumers is known as exportation.

Consider the following example: Whereas Lebanon may be a good place to grow fruits, the same cannot be said about Sweden. Sweden does not have the necessary land or labor to produce fruits on a large scale. In this situation, it may be in Lebanon’s interest to export fruits to Sweden. Likewise, in order to satisfy the wants and needs of Swedish consumers, Swedish grocery stores may want to procure fruits from Lebanese producers. The act of purchasing goods from a foreign country in order to sell them domestically is known as importation.

The previous example involved only two countries and one product. However, the international trading system in which we operate is comprised of dozens of countries and the thousands—if not more—of products they individually produce. Moreover, it is often the case that several countries are similarly suited to produce the same types of goods and services, and this places them in direct competition with each other.

Take a few minutes to think about the scenario presented above, and ponder the following questions:

- Should all fruits from all countries be treated equally?
- If the importation of fruits reduces the domestic price of fruits, or reduces consumption of domestically produced fruits, should we forbid it?
- Is trade bad?

2.1 Arguments in Favor of International Trade

This section will focus on various economic and non-economic arguments in support of international trade. After reading this section, you should be able to answer the questions presented in the paragraph above.
2.1.1 Economic Arguments in Favor of International Trade

The example we analyzed above, in which Sweden and Lebanon became trading partners, is based on the theory of absolute advantage. According to this theory, country X has an absolute advantage in the production of a good when country X is able to produce more of that specific good than country Y. Most countries have an absolute advantage in the production of certain goods. Given that each country is better than others at producing certain goods, they specialize and trade their excess production.

As you might have intuited, the world is more complicated than the scenario we presented above between Sweden and Lebanon. Often, countries have very similar factors of production, and therefore are able to produce similar amounts of the same goods. To rationalize trade in such a scenario, a more complete and complex theory is needed. This theory is called the theory of comparative advantage. A comparative advantage exists whenever a country has “a greater margin of superiority or a smaller margin of inferiority”\(^1\) in the production of a good. It is possible for a country not to have an absolute advantage in the production of a good, but it may still have a comparative advantage if it is relatively better suited for the production of a certain good than another country might be.

Let us use the following scenario to understand the theory of comparative advantage. In this scenario, there are two countries: Techno and Agro. Techno is an industrialized country, and Agro is still developing and has not yet reached the same level of industrialization as Techno. Notwithstanding, both countries produce televisions and lamps, and both countries have 1,000 workers.

To produce one television per hour, Techno uses 10 workers, and Agro uses 100; and to produce one lamp per hour, Techno uses 2 workers, whereas Agro uses 4. Let us assume that half of each country’s workers produce televisions, and the other half produces lamps. If we do the math, we will find that Techno can produce 50 televisions and 250 lamps per hour. Conversely, Agro can produce 5 televisions and 125 lamps per hour. In this example, Techno has an absolute advantage in the production of both goods.

Let us now think about how lamp production would change if each country decided to produce more televisions. Assume Techno wants to produce 51 televisions instead of 50, and that Agro wants to produce 6 televisions instead of 5. Given that instead of producing lamps, some workers will produce televisions, the output of lamps for Techno decreases to 245, and the output of lamps for Agro decreases to 100 lamps. It costs Techno 5 lamps to produce 1 television, whereas it costs Agro 25 lamps to produce 1 television.

Now let us think about what would happen if each country decided to produce one more lamp instead of one more television. Again, because some workers that were producing televisions will now be producing lamps, the television output must decrease in some amount. A simple calculation will show us that increasing lamp output to 251 will decrease Techno’s television output to 49.8 televisions, whereas increasing lamp output to 126 would decrease Agro’s television output to 4.96. It costs Techno .2 televisions to produce one lamp, whereas it costs Agro .04 televisions to produce one lamp.

If we compare the costs of producing 1 additional television and 1 additional lamp for each country, we will discover the following: it is relatively cheaper for Techno to produce televisions, and relatively cheaper for Agro to produce lamps. Therefore, Techno has a comparative advantage in the production of televisions and Agro has a comparative advantage in the production of lamps. If Techno and Agro specialize in the production of the good they have a comparative advantage in, they will be left with more televisions and lamps than they can consume domestically. If they trade, they will be able to consume more of both goods than if they each attempted to produce televisions and lamps independently.

The theory of comparative advantage tells a compelling story of why international trade is beneficial. However, there are many more arguments in favor of increased trade amongst countries. For instance, trade between countries tends to expand the markets that domestic producers can access, allowing them to produce at a scale that will keep their costs down. Additionally, trade may lead to the spread of new technologies, which can be particularly valuable in developing economies.

The economic rationales in favor of international trade are strong, but they are not a complete representation of the pro-trade argument. Nonetheless, understanding them is a key element to fully grasping the underpinnings of many rules and goals of the current international trade system.

2.1.2 Non-Economic Arguments in Favor of International Trade

In addition to the economic arguments articulated above, there are many non-economic rationales supporting international trade. Some scholars argue that international trade, and more specifically free trade—defined as trade without barriers—promotes peace. The idea behind this argument is that countries that actively trade with each other are less likely to engage in a

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3 *Id.*
4 *Id.*
war or conflict against one another. As evidence of this, scholars point to history, and note that only on rare occasions has this theory been contradicted in modern times.

Some have argued that trade promotes democracy and peace, forming a ‘virtuous cycle.’ They suggest that trade and economic integration tend to promote the introduction of democratic ideas to society. This is ostensibly because increased trade also leads to an increase in the inflow of books, and other forms of “political and social content.” Moreover, scholars contend that “[f]oreign investment and services trade create opportunities for foreign travel and study, allowing citizens to experience first-hand the civil liberties and more representative political institutions of other nations.” Additionally, they introduce three main ways in which trade and globalization reinforce the “trend toward democracy.” First, as explained above, it is rather unlikely that democracies that trade with each other will fight one another. Second, trade promotes economic integration, which means that economies are more linked and thus that countries have more to lose from fighting each other. Third, trade allows countries to depend on production and exchange to acquire wealth instead of depending on war and conquest.

We have already covered the main arguments in favor of international trade, both economic and non-economic. Now, we shall explore the arguments against trade.

2.2 Arguments Against International Trade

The practice of preventing or limiting international trade with the ultimate goal of protecting domestic producers is known as protectionism. We will discuss different types of protectionist measures in subsequent sections, and will learn that not all protectionism is equally bad. This section will focus only on the arguments in support of protectionism.

One of the most popular arguments against the free trade of goods across international borders is the infant industry argument. The infant industry argument contends that allowing the importation of goods and services into a country is detrimental to domestic producers, particularly when the domestic industry is young and relatively uncompetitive.

Consider the two countries from our previous example, Techno and Agro. Now assume that Techno is the world’s most experienced producer of computer chips and that Agro is a newcomer to the computer chip industry. Allowing Techno’s computer chips to enter Agro’s domestic market might drive Agro’s domestic producers out of business because they might not be able to compete with Techno’s superior quality and lower prices.

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5 Id.
6 Id.
There is a counterargument to the infant industry argument, and it is that allowing trade will ensure that only the most efficient domestic producers survive. Additionally, domestic consumers will be better off because they will have access to the best and cheapest products on the market. Some scholars suggest that the infant industry argument is a “smoke screen” and that it is merely a justification for the tariffs imposed on certain non-domestic industries to protect domestic industries with political power. It has also been suggested that most infant industries “never grow up,” which ultimately defeats the infant industry argument because protection of the infant industries is only acceptable if they eventually flourish.

The second argument in favor of protectionism is centered around the existence of domestic market failures that are too costly to correct. This argument posits that the only way in which a “hands-off” policy is acceptable in one market (i.e. the market for goods) is if all other markets are working properly. For instance, let us use capital markets as an example. Capital markets are financial markets where you can buy and sell financial instruments such as debt. Now assume that capital markets in Iraq are not functioning correctly and that fixing them may be incredibly difficult or costly. A dysfunctional capital market makes it very difficult for domestic producers to obtain financing. Thus, the government may choose to fix this problem by financing domestic production of a good instead of fixing the capital market. The main counterargument for the domestic market failure rationale is that it is more reasonable to institute domestic policies aimed directly at the failure, than to institute short-term fixes in different yet related markets.

The third argument we shall address is a partial rebuttal of the comparative advantage theory. As you may recall, comparative advantage is the idea that every country should produce that which its factors of production make it most efficient at producing. According to this theory, all countries will benefit from specialization and trade because they will increase their wealth. However, this does not mean that every individual within each country will be better off; it simply means that the “winners” will win more than the “losers” lose, and the country overall will be in a better position after trade.

If appropriate wealth redistribution mechanisms existed in each country, then it would be possible to efficiently compensate the “losers” from trade (e.g. industries that go out of business, individuals whose jobs no longer exist, etc.). Additionally, even when such mechanisms exist, redistribution rarely takes place, and thus only a portion of society benefits from trade, while the rest of society suffers.

The last argument against international trade that we will be addressing is grounded in national security concerns. This argument suggests that for a country to be able to defend itself, it must have all the goods necessary to do so. In other words, it must be self-sufficient in certain sectors. For instance, if a country is going to war, it should have all the steel it needs to be able to

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produce weapons. If it has no capacity to produce steel and relies exclusively on imports, it might find itself in a precarious situation should a conflict arise. This argument, however, clearly does not apply to all sectors.

Now that we are familiar with the benefits and drawbacks of international trade, we shall learn about the current international trading system. The following sections will cover its history, its structure and organization, and its substantive rules.

3 THE HISTORY AND STRUCTURE OF THE CURRENT INTERNATIONAL TRADE REGIME

This section will begin with a brief history of the World Trade Organization ("WTO") and its founding documents. It will then proceed to explaining how the WTO functions. Finally, this section will explain the role that developing countries play in the current international trade regime, and how their position has developed through time. After reading this section, you will be familiar with the context in which the rules of international trade operate. Accordingly, we will proceed to learning about the rules of international trade in section 4.

3.1 History

The current international trade regime is the product of decades of multilateral negotiations. Beginning with the General Agreement on Tariffs and Trade (GATT), and ending with the creation of the World Trade Organization (WTO), this section will provide you with the context necessary for understanding the organizations and rules governing international trade.

3.1.1 The General Agreement on Tariffs and Trade

In the aftermath of World War II, the leaders of the Western world were keen to reverse the mistakes of economic isolationism that plagued the pre-war years. They believed that freer trade would in the long term be mutually advantageous for economic and security reasons. Thus, the United Kingdom and the United States began discussing the establishment of a trade organization. The job of this organization would be the creation and enforcement of a uniform set of trade rules, agreed upon by its member states. Moreover, its intended goal was to promote trade across international borders with limited government interference.

In 1945, the United States submitted a document to the United Nations, calling for the creation of what was then called the International Trade Organization (ITO). This plan led to the commencement of a long string of negotiation rounds, all with the purpose of promoting trade across borders. For a variety of reasons, the ITO never materialized. Nevertheless, the concessions resulting from the negotiations were recorded in what is known as the General Agreement on Tariffs and Trade (GATT 1947). Given that the ITO never came into existence, no
organization was formally charged with implementing the GATT. Notwithstanding, the GATT was implemented through a Protocol of Provisional Application, which lasted almost fifty years.

Originally, the GATT was controlled by industrialized nations, and therefore did not address the concerns of developing countries. Notably, the Middle East was poorly represented in GATT 1947—only two of the twenty-three Contracting Parties, Lebanon and Syria, were from this part of the world. Moreover, many of the developing countries included as Contracting Parties had only recently left the sphere of influence of European powers (e.g. Burma, India, Pakistan, etc.).

Between 1947 and 1979, the GATT’s Contracting Parties undertook seven rounds of negotiations—including the 1947 round. Throughout these years, the number of Contracting Parties increased from a meager twenty-three to a substantial one-hundred-and-two at the Tokyo Round of Negotiations.

3.1.2 The Uruguay Round and the Creation of the World Trade Organization (WTO)

In 1986, the most important round of negotiations to date commenced in Punta del Este, Uruguay. Known as the Uruguay Round, this round led to the creation of an international organization devoted to trade. The Marrakesh Agreement of 1994 marked the end of the Uruguay Round of negotiations and the establishment of the World Trade Organization (WTO). It also marked the end of the GATT years, but only to a certain extent. Although the GATT was no longer the pre-eminent international trade “organization,” its rules, ancillary agreements, and concession schedules were adopted by the WTO.

3.2 Overseeing International Trade—The WTO and its Functions

Composed of over one hundred and sixty Member States, the WTO is the world’s preeminent trade organization. This section will outline the basic structure of the WTO, its guiding documents, the composition and responsibilities of each of its branches, its membership, and its dispute resolution mechanism.

3.2.1 The Structure of the World Trade Organization

The WTO Agreement establishes the structure of the WTO in Article IV. At first glance, the WTO’s structure seems complicated, but it is actually rather simple. We will approach this section in a top-down manner, starting with the WTO’s highest authority, the Ministerial Conference, and ending with the Secretariat.

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The Ministerial Conference is the WTO’s highest decision-making body. As the highest authority within the WTO, the Ministerial Conference is charged with making decisions on all matters under any of the multilateral agreements. One step below the Ministerial Conference is the General Council. The General Council is composed of the same members as the Ministerial Conference and provides overall supervision of the WTO between meetings of the Ministerial Conference. In addition to its oversight duties, the General Council may meet under different terms of reference as the Dispute Settlement Body (DSB) and as the Trade Policy Review Body (TPRB). As suggested by their names, each of these bodies has different responsibilities.

The Secretariat of the WTO is charged with a variety of administrative duties. Although the duties it carries out for the WTO are incredibly important, its budget is relatively small. The Secretariat is funded by the Member States based on their share of world trade. Regardless of the fact that a single state may be responsible for a greater proportion of the funding than others, the Director General and the Secretariat staff are forbidden by the WTO Agreement from seeking or accepting instructions from an individual government of authority outside the WTO.

**Annex 1 – Organizational Chart of the WTO**

Now that we understand how the WTO is organized, we will move on to learning about the various agreements that guide the international trading system.

### 3.2.2 The Guiding Documents of the WTO

We have mentioned several agreements in this chapter (e.g. GATT, WTO Agreement, DSU, etc.), but we have not explored each of them individually. This section will provide you with an overview of the most important agreements related to trade in goods and services.

The Marrakesh Agreement Establishing the World Trade Organization, commonly known as the WTO Agreement, was signed on April 15, 1994. Aside from calling for the creation of the WTO, this agreement defines its scope (Article II), its functions (Article III), its structure (Article IV), its relations with other organizations (Article V), etc. Moreover, Annex 1 of the WTO Agreement provides an exhaustive list of the agreements and treaties that govern international trade. All the agreements included in Annex 1 are treated as “integral parts” of the WTO Agreement and binding on all of its Members.

The General Agreement on Tariffs and Trade (GATT) contains all the substantive rules by which the WTO’s Member States are expected to abide. Its power is limited by its scope of application—the GATT applies only to trade in goods, and only briefly addresses trade in services, investment, intellectual property, and environmental issues. Notwithstanding, it is the most widely known international trade agreement and the model for many subsequent trade agreements, such as the General Agreement on Trade in Services.
There are two General Agreements on Tariffs and Trade, one signed in 1947 and one signed in 1994. The difference between GATT 1947 and GATT 1994 is that GATT 1994 fully incorporates GATT 1947, “as rectified, amended or modified by the terms of legal instruments which have entered into force before the date of entry into force of the WTO Agreement.” This means that GATT 1994’s scope of application is broader because it includes agreements and legal terms drafted following the ratification of GATT1947. Instead of rewriting the GATT to reflect changes in its existing articles, and amending it with the most recent legal instruments, the WTO’s Member States decided to adopt it with certain qualifications.

The General Agreement on Trade in Services (GATS) fulfills a similar purpose as the GATT, except that its scope of application is limited to trade in services. Given that liberalization of services necessarily leads to the liberalization of investment, GATS disputes sometimes revolve around foreign investment. GATS subjects Members to many of the same principles and rules as the GATT.

Formally known as the Understanding on Rules and Procedures Governing the Settlement of Disputes, the Dispute Settlement Understanding (DSU) outlines the rules and procedures that control the settlement of trade disputes between WTO Members. The strictures of the DSU apply to disputes arising from any of the WTO’s covered agreements. Optimally, disputes are to be settled by consultation between Members. When that does not occur, the DSU grants the WTO’s General Council, when sitting as the Dispute Settlement Body, power to adjudicate such disputes.

The following are a few of the most important multilateral agreements applicable within the GATT/WTO system:

- The Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, commonly known as the Anti-Dumping Agreement (AD), is one of the most important agreements in the GATT/WTO system. The AD provides a functional definition of dumping, one of the most notable unfair trade practices consisting of selling goods in a foreign market at a price lower than the cost of production, and establishes the process for remedying the harm caused to a Member when dumping is found.
- The Agreement on Subsidies and Countervailing Measures (CM), provides a functional definition of subsidies, and establishes the process for remedying the harm caused to a Member by a forbidden or actionable subsidy.

### 3.2.3 Membership of the WTO

During the period of provisional application, all GATT signatories were known as Contracting Parties. The reason for this was that the GATT was not an organization, and therefore countries could not formally be known as “Members.” This changed with the creation of the WTO. Upon
the entry into force of the WTO Agreement, all its signatories became Members of the World Trade Organization.

To join the WTO, interested parties must go through the process of accession. Article XII of the WTO Agreement lists the basic requirements that must be fulfilled by a state in order to be eligible to begin the accession process. Specifically, a party that wishes to accede to the WTO must be either a State or a separate customs territory “possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in [the WTO Agreement] and the Multilateral Trade Agreements…” Additionally, the WTO Agreement sets forth a variety of procedural and substantive requirements that must be fulfilled in order to accede to the WTO. Iraq is currently in the process of acceding to the WTO, and therefore is considered an Observer State. Although it is not yet a Member of the WTO, many of the strictures of the GATT are applicable to Iraq by virtue of the trade agreements it has signed with nations around the world. For instance, the Partnership and Cooperation Agreement Between the European Union and Iraq incorporates many of the GATT’s main substantive rules, and applies to all trade between Iraq and the countries of the European Union. However, given that Iraq does not have access to the Dispute Settlement Body of the WTO, it does not enjoy the same protections as WTO Members. If Iraq completes the accession process, it will come under the jurisdiction of the DSB, and will thus be a more attractive trading partner for other states. Accession is composed of four phases: the examination phase; the substantive phase; the membership terms phase; and the decision phase.

A country that no longer wishes to be a Member of the WTO may withdraw from the organization. Article XV of the WTO Agreement states that a withdrawal “shall take effect upon the expiration of six months from the date on which written notice of withdrawal is received by the Director-General of the WTO.” This means that a country wishing to withdraw may not immediately suspend its trade commitments. By forbidding the immediate suspension of concessions, the WTO Agreement gives affected Members a reasonable period of time to adjust their trade policies following the withdrawal of a Member. Ultimately, the goal of the six-month time lapse is to reduce shocks in international trade and in the individual economies of the WTO’s Members.

### 3.2.4 Dispute Resolution in the WTO

International trade relations have always been a source of friction between countries. Since the establishment of the WTO, almost five hundred disputes have arisen between WTO Members. This number may seem relatively small when compared to the number of cases brought before the courts of an individual country, but the number is offset by the intricate nature of a trade dispute. A single case can last multiple years, and a report by the Dispute Settlement Body (DSB) can be well over three-hundred pages long. Another reason why there are not more formal disputes is that the WTO encourages its members to resolve trade disputes on their own through
consultations. Often, opening the channels of communication is all that is needed to reach an amicable solution. Other times, this is not the case, and the DSB is called to intervene.

3.2.5 The Dispute Settlement Body and its Role in Dispute Resolution

The Dispute Settlement Understanding (DSU) provides in Article 3 that the DSB’s job is to “preserve the rights and obligations of Members under the covered agreements.”\(^\text{12}\) Earlier in this chapter, we learned that the “covered agreements” are those included in the annexes of the WTO Agreement. Article 3 of the DSU also stipulates that the goal of the dispute settlement process is to reach a positive and mutually agreeable solution for the parties involved. If a mutually agreeable solution is not possible, the DSB’s objective shifts to that of forcing the infringing Member to conform to its obligations. Thus, the role of the DSB is to encourage the amiable resolution of disputes in the first instance, and to secure the preservation of a Member’s rights when an amicable solution cannot be reached.

3.2.6 A Procedural Overview of Dispute Settlement in the WTO

When a trade dispute arises within the WTO system, the first step that an affected Member must take is to begin consultations with the infringing Member. Even then, Article 3.7 of the DSU provides that a Member should “exercise its judgment as to whether action under these procedures would be fruitful.”\(^\text{13}\) Understandably, the WTO wants to avoid frivolous disputes that could and should be taken care of in a different forum.

If a Member decides that commencing consultations would be “fruitful,” it may make a request for consultations to another Member. Upon doing so, the Member to which the request for consultations is made has ten days to respond to the request. If the Member agrees to begin consultations, then they must begin within thirty days after the date of receipt of the request. If consultations fail, a complaining Member must submit a written request to the DSB for the establishment of a dispute settlement panel. Requests must state whether consultations took place and under which agreement the dispute is arising. The request must also identify the measures at issue and present a summary of the claim’s legal basis.

Panels are composed of either three or five “well-qualified governmental and/or non-governmental individuals…selected with a view to ensuring the independence of the members, a sufficiently diverse background and a wide spectrum of experience.”\(^\text{14}\) To assist in the selection process, the Secretariat nominates potential panelists and presents them to the parties to the dispute. The parties can only reject a panelist’s nomination for a compelling reason. If the parties agree to a panel, the parties move on in the dispute settlement process. If the parties cannot agree

\(^{12}\) Article 3.2, Dispute Settlement Understanding

\(^{13}\) Article 3.7, Dispute Settlement Understanding

\(^{14}\) Article 8.1-8.7, Dispute Settlement Understanding
on the composition of the panel within twenty days of its establishment, the WTO’s Director-General must then appoint the panelists.

Once a panel is satisfied that it has heard both sides of the dispute in accordance with the Working Procedures of Annex 3, the panel must write a detailed report of its findings. Members may object to the panel’s findings in writing prior to the report’s adoption by the DSB. Thereafter, in deciding whether or not to adopt a report, the DSB must fully consider and record each party’s views. If a party is not satisfied with the findings of the report, it may appeal the panel’s decision.

The Appellate Body is in charge of hearing appeals brought by Members who are dissatisfied with the outcome of a panel report. The standing Appellate Body is composed of seven people, only three of whom are assigned to a case at one time. Its members are “persons of recognized authority, with demonstrated expertise in law, international trade and the subject matter of the covered agreements generally.” Moreover, they cannot be affiliated to any government.

Appeals are “limited to issues of law covered in the panel report and legal interpretations developed by the panel.” This means that the Appellate Body may not raise new issues of law and may not challenge the facts of a case. The Appellate Body may only “uphold, modify or reverse the legal findings of the panel.” In certain instances, this entails completing a legal analysis or taking a completely new approach to the legal issue at hand. The reason the Appellate Body is allowed to make such changes to the panel report is that there is no opportunity for a rehearing before the panel, and its findings are final.

Upon concluding its review of the panel report, the Appellate Body produces a report of its findings. The report is then adopted by the DSB unless Members decide, by consensus, not to adopt it. Once the Appellate Body’s report is adopted, it is “unconditionally accepted by the parties to the dispute.”

In cases where the Appellate Body concludes that a Member’s actions are inconsistent with a covered agreement, it must recommend that the Member “bring the measure into conformity with [the] agreement.” To facilitate this process, the Appellate Body may also propose viable ways for a Member to implement its recommendations. From the moment the Appellate Body’s report has been distributed, the offending party is given fifteen months to implement or state its intention to implement the report. If the offending party refuses to bring its measure into conformity with the agreement, the prevailing Member may request monetary compensation, or

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15 Article 17, Dispute Settlement Understanding.
16 Id.
17 Id.
18 Id.
19 Id.
20 Article 19, Dispute Settlement Understanding.
additional concessions equal in monetary value to the damage caused by the offending party’s measure. If the offending party refuses to provide compensation or additional concessions, the prevailing Member may request permission from the DSB to suspend its concessions to the offending party. Generally, suspending concessions is seen as a last resort given that it is detrimental to international trade.

3.3 The Role of Developing Countries in the Current International Trade Regime

The Preamble to the WTO Agreement recognizes that its Member States’ “relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production and trade in goods and services . . . .”21 Furthermore, it provides in relevant part that “there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in growth in international trade, commensurate with the needs of their economic development.”22 From these excerpts, we can glean some of the main goals and purposes of the World Trade Organization, namely that all its Member States enjoy the benefits of international trade, and that there be as little disparity as possible between the benefits conferred on a developed country, and those conferred on a developing country. As you will come to recognize, this balancing act is not simple.

Scholars have distinguished between two types or systems: “rule-oriented” and “power-oriented.”23 A rule-oriented system is one in which all relations between members are fully controlled and guided by a discrete set of rules; these rules apply to all equally. A power-oriented system is one in which all relations between members are fully controlled and guided by the regime’s members; some members have more power than others, and thus receive better treatment within that system.

Some posit that with the creation of the GATT/WTO system, the international trade regime moved toward the rule-oriented end of the spectrum. However, scholars contend that the power of individual members (Member States in the WTO) “remains an important element in terms of Members’ participation in the system.”24 This is particularly visible in two main arenas: the negotiation process and the dispute settlement system.

21 Id.
22 Id.
24 Id.
Although the WTO’s rules apply to every Member State regardless of its position of power or influence, their creation is often driven by the will of developed countries. When negotiating the implementation of a new agreement or setting the agenda for a round of negotiations, a “member’s relative power continues to be an important force in determining the nature of the obligations that are undertaken and avoided.” Thus, given the power disparity between negotiators, the system and its rules tend to favor the more powerful developed countries.

The WTO’s dispute settlement mechanism is regarded as one of the main successes of the Uruguay Round, but critics contend that it is not an effective tool for developing countries. The two main aspects of this critique are that developing countries do not have the resources to effectively utilize the dispute settlement mechanism; and that the dispute settlement rules are inherently unfair toward developing countries. In terms of resources, the argument is that one cannot expect a developing country to have the necessary resources to put on a strong enough case before the WTO, and therefore, the developing country may not have a chance to win. As for the unfair rules, the argument is that the size and power of a developed country’s market effectively shields it from any harm that may come from the adverse resolution of a dispute, whereas a smaller developing country could be greatly affected.

So far, we have learned the basic rationales for international trade, the history of today’s international trade regime, and its main pitfalls. We have also been introduced to the structure and workings of the WTO. Next, we will discuss the main rules of international trade and how they are implemented.

4 THE RULES OF INTERNATIONAL TRADE: MAIN PRINCIPLES, EXCEPTIONS, AND REMEDIES

So far, we have learned about the arguments underlying international trade, the history of the prevalent international trade regime, and the inner-workings of the WTO. The next step in our voyage is to survey the substantive laws of international trade. We will focus on three main aspects of international trade in this chapter, namely, the pillars of international trade law and the rules derived from them, exceptions to these rules, and the remedies to unfair trade practices.

4.1 The Main Principles of International Trade

The modern international trade regime is based on four main principles. These principles are, in no particular order of importance, Most-Favored-Nation Treatment (MFN), National Treatment (NT), tariff binding, and the general prohibition of quantitative restrictions. Each of these is codified as a separate rule in the GATT.

Below, you will find a brief explanation of each rule, followed by an example of how the rule operates. After reading this section, you should be able to articulate the four main rules of international trade. You should also be able to apply each rule to a basic fact pattern.

### 4.1.1 Treating all Countries Equally: The Principle of Most-Favored-Nation

The first substantive rule of international trade that we will delve into is known as **Most-Favored-Nation Treatment (MFN)**. Most-Favored-Nation is based on the idea that every member state should treat each of its trading partners equally. Assuming that the products of country X are the same as those of country Y, a state should not give preferential treatment to the goods of one country in detriment of those of another. The importance of Most-Favored-Nation is underscored by the fact that it is addressed in Article I of the GATT. Article I of the GATT provides that any “advantage, favor, privilege or immunity” granted by a contracting party to the goods of another contracting party, “shall be accorded immediately and unconditionally to the like product” of all other contracting parties.\(^{26}\)

Article I was envisioned to have two main applications. First, whenever WTO members negotiate and grant trade concessions to other countries, such concessions must automatically be extended to all other WTO Members. Second, outside of trade negotiations, whenever a WTO Member enacts legislation or certain trade-restrictive rules or requirements, it cannot, according to Most-Favored-Nation, discriminate between products from a WTO Member and the like products of any other country. The following example will illustrate how Most-Favored-Nation operates:

**Application Exercise #1**

A) In this example, Iraq is a major importer of foreign cars, and has just instituted a measure providing duty-free treatment for imports of automobiles, buses, and specified commercial vehicles. Now assume that the duty exemption applies to imports from all countries, but that in order to qualify for the exemption, a car producer must meet certain requirements. If the requirements can only be met by producers from Turkey, China, and Germany, is Iraq actually providing Most-Favored-Nation treatment to all of its trading partners?

In an analogous case involving Canada, the DSB found that “by reserving the import duty exemption…to certain producers, Canada accord[ed] an advantage to products originating in certain countries which advantage is not accorded immediately and unconditionally to like products originating in the territories of all other WTO Members. Accordingly, [] the application

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of this measure [was] inconsistent with Canada’s obligations under Article I:1 of the GATT.”

So, as you can see, a country’s Most-Favored-Nation obligations under the WTO are not very flexible. If a concession or advantage is granted to one trading partner, then it must be granted to all trading partners, unconditionally.

4.1.2 Treating all Goods Equally within a Given Market: The Principle of National Treatment

Like Most-Favored-Nation, National Treatment (NT) is a subset of the principle of nondiscrimination. However, National Treatment has a domestic focus. Essentially, National Treatment is based on the idea that a country should treat imported goods the same way as it treats domestically produced goods. For instance, assuming that the products that Country X imports are substantially the same as those it produces domestically, it should not offer imported products worse treatment than that offered to domestically produced goods.

National Treatment has two distinct applications. The first is based on internal taxation, and the second is based on internal regulation. GATT Article III codifies National Treatment through its provisions on Internal Taxation and Internal Regulation. Ad Article III explains the rule’s scope. An Ad Article is an explanatory note provided by the drafters of treaties to clarify the purpose and intended interpretation of a specific treaty provision.

At its core, Article III:2 stipulates that imported products should not be subject to internal taxes or other internal charges in excess of those applied to like domestic products. **Internal Taxes** are those applied to a good after it has crossed a country’s borders. Similarly, Article III:4 provides that imported products may not be subject to more stringent laws, regulations, or requirements than those applicable to like domestic products. **Internal Regulations** are those applied to a product after it has crossed a country’s borders. The following hypothetical will illustrate how Article III:2 operates:

### Application Exercise #2

Assume Morocco has instituted an internal tax that applies to dates. Under the tax scheme created by the Moroccan government, a tax of 7% *ad valorem* (of the value) is levied on dates with sugar content between 3% and 10%, whereas a tax of 25% *ad valorem* is levied on dates with sugar content higher than 10%. On its face, this taxation scheme does not seem to differentiate between domestically produced and imported products. However, if 90% of imported dates fall within the 25% tax bracket, and the majority of dates falling within the 7% tax bracket are Moroccan, can it be said that Morocco is affording its trading partners National Treatment?

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In an analogous situation concerning Japanese shochu (an alcoholic beverage), the WTO’s DSB found that applying different tax rates to shochu and vodka was inconsistent with its WTO obligations. The reason for this finding was that in the DSB’s opinion, shochu and vodka were like products and that the practice of taxing them at different levels had no basis other than affording protection to domestic production. Like products are those with similar end uses, similar properties, similar natures, and similar qualities. In summary, the WTO’s DSB has stated that a determination of this type must be based on whether the products being taxed at different levels are like products, and whether the different taxation levels have the purpose of affording protection to domestic production.

As explained above, Article III:4 on internal regulation is based on the idea that a country should not subject goods to less favorable internal regulations merely because they were not produced domestically. The hypothetical below will illustrate how Article III:4 operates:

**Application Exercise #3**

Assume Turkey has just passed a law banning the manufacture, processing, sale, import, placing on the domestic market and transfer of all varieties of linen. However, it still allows the manufacture, processing, sale, import, placing on the domestic market and transfer of all varieties of natural cotton. If linen and cotton are interchangeable products, could it be said that Turkey’s internal regulation is inconsistent with its international obligations?

In a similar case concerning asbestos, the WTO’s DSB found that a French measure banning the manufacture, processing, sale, import, placing on the domestic market and transfer of all varieties of asbestos was inconsistent with its Article III:4 obligations. The DSB reached this finding after determining that asbestos and other non-asbestos fibers were like products. Notwithstanding, the DSB found that France’s inconsistent measure was justifiable given that it was enacted for the purpose of protecting human life or health. The Appellate Body reversed the panel’s findings, and decided that given the health repercussions of using asbestos, asbestos and other non-asbestos fibers were not like products. However, this was based on the application of an Article XX exception, which we will discuss below. As with the previous example, a determination of this kind commences with a likeness analysis. If the products are considered to be like products, then a country must have a good justification for enacting the WTO inconsistent regulations.

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By now you may have noticed that many of the arguments set forth by the parties to a WTO dispute are based on issues of treaty interpretation. In the previous two hypotheticals, the cases turned on whether or not the products could be considered like products. Clearly, the wording of a treaty has meaningful repercussions when attempting to apply its provisions.

**4.1.3 Tariff Binding**

Most products are subject to tariffs (import taxes) upon being imported to another country. There are two different types of tariffs that can be imposed, ad valorem and specific. Ad valorem tariffs are those that are equal to a certain percentage of the value of a good. For instance, a tax equal to 10% of the value of an imported car is an ad valorem tariff. A specific duty is a tariff that does not depend on the value of the good, but is applied on a per-unit basis. A tariff of 10 Iraqi Dinars charged for each kilogram of apples imported into Iraq is considered a specific duty.

Protectionism is never desirable, but this does not mean that certain types of protectionism are not better than others. It is in every country’s interest that their trading partners’ protectionist practices are transparent. Transparent protectionist measures make it easier for producers worldwide to make informed decisions regarding which markets they should enter and which ones they should not. Transparent protectionist measures also make it easier for countries to identify situations where their producers are being unfairly discriminated against. Accordingly, tariffs are the least undesirable of protectionist measures.

One of the most important elements of the GATT is its schedule of concessions. This schedule of concessions lists the results of several bilateral trade negotiations regarding tariff levels. If you look back to our discussion of the WTO accession process, you’ll be reminded of the importance of tariff negotiations.

GATT Article II codifies WTO Members’ obligation to abide by negotiated tariff schedules, whereas GATT Article VIII limits the types of charges that may be applied by countries in addition to those imposed on the importation of a good. Additionally, Article II limits the charges that can be imposed on the importation of a good to those bilaterally agreed upon and listed in a country’s tariff schedule. Conversely, Article VIII limits the charges that can be imposed in relation to the importation of a good, but not on the good itself. A country is free to negotiate different tariff levels for different products, but it must always abide by its Most-Favored-Nation and National Treatment obligations. The following hypothetical provides an example of how Article II operates:
In this hypothetical, Turkey has agreed to a tariff of 20% on imported mangos. However, Turkey has also institute a minimum specific duty for imported mangos. Furthermore, the way Turkey has decided to apply this import duty to mangos is that if the actual tariff of 20% is higher than the minimum specific duty, then the 20% rate applies, but if the 20% tariff is lower than the minimum specific duty, then the minimum specific duty applies. Is this practice consistent with Turkey’s international obligations under Article II?

In an analogous case, the WTO’s DSB found that a scheme that allows for the levying of duties higher than those agreed upon with a country’s trading partners, is inconsistent with Article II. It does not matter how many taxation systems a country wishes to implement, as long as the taxes applied to a certain good are not above those agreed upon between the parties. In this case, the system created by Turkey was inconsistent with Article II because it made it possible for a tariff higher than 20% of the value of an imported mango to be levied, under certain circumstances.

4.1.4 Ban on Quantitative Restrictions

With only a few notable exceptions, the GATT forbids the imposition of quantitative restrictions on international trade. It should be no surprise that an agreement intended to liberalize trade would not look fondly upon measures that function as absolute barriers to it. Quantitative restrictions are usually in the form of quotas. A quota is a limit imposed on the quantity of a good that can be imported. Although quantitative restrictions may be politically popular given that their results are immediate and direct, they are not desirable from an economic perspective. The reason for this is that quantitative restrictions have a greater distortive effect on the market than any other protectionist measure.

Unlike tariffs and internal measures, which affect the price of a good and leave it to importers and consumers to determine what the efficient quantity is, quantitative restrictions impair the economy’s ability to determine an efficient price and quantity. A small enough quota may cause the price of a good to reach unsustainable levels, thereby forcing domestic consumers to either change their preferences or purchase goods at unrealistically high prices. Moreover, it may encourage domestic producers to increase their output of low quality goods to fill the gap between domestic demand for a good and its availability.

GATT Article XI codifies the general prohibition against quantitative restrictions. However, it lists a few exceptions to this ban, including quantitative restrictions imposed to “relieve critical shortages of foodstuffs” or other essential products, and restrictions intended to remove surpluses

from the market. The hypothetical below will provide you with a general overview of how Article XI operates:

**Application Exercise #5**

This hypothetical situation concerns Pakistan. Assume that for a variety of reasons Pakistan is the world’s most efficient producer of microchips. Now assume that Pakistan’s microchips are hurting other countries’ domestic markets for microchips because of their incredibly low prices. If Pakistan agrees with a WTO Member to monitor costs and prices of microchips, and if necessary, prevent their sale to another Member, is this consistent with its Article XI obligations?

In an analogous case, the WTO’s DSB found that a two-part test had to be satisfied in order for a measure to constitute a contravention of Article XI. First, the DSB had to determine whether there were “reasonable grounds to believe that sufficient incentives or disincentives existed for non-mandatory measures to take effect.” Second, the “operation of the measures to restrict exports of [the good] at prices below company-specific costs [had to be] essentially dependent on Government action or intervention.”31 In essence, quantitative restrictions can be both import and export oriented. Moreover, there is a two-part test to determine whether a measure may be characterized as a quantitative restriction.

**For Further Consideration**

**Oil in the WTO**

“Petroleum is the largest primary commodity of international trade in terms of both volume and value.”32 It is also the source of livelihood for countries such as Saudi Arabia, the United Arab Emirates, Iraq, and Nigeria. All these countries are members of OPEC, and all with the exception of Iraq are members of the WTO. We have already analyzed several rules of international trade. If we couple our knowledge of these rules with our knowledge of the way in which the international oil market works, and the way in which OPEC conducts itself, what stands out? At first glance it seems to be that there would be a conflict between a country’s WTO obligations and OPEC’s practices.

A superficial analysis of the GATT and the multilateral agreements covered by the WTO Agreement yields the following truth: oil is not exempt from the strictures of international trade law. However, “a combination of factors has, de facto, brought the virtual exclusion of...


international trade in petroleum products from the trading system.”33 The level of deference offered to this de facto exclusion is such that even blatant disregard for the rules of international trade, such as quantitative restrictions in the form of production cuts and export restrictions, go unchallenged in the WTO. In fact, “no formal GATT/WTO complaint has ever been lodged so far against oil exporting WTO Member Countries that resort to supply restrictions.”34 However, even if these GATT inconsistent practices were challenged, such a challenge would be unlikely to prevail. Why? Simple—the answer is GATT Article XX. We will discuss GATT Article XX in detail below. In essence, it is an escape clause for countries that need to avoid their WTO obligations without incurring the wrath of the DSB.

Many countries are hesitant to join the WTO. They fear that in joining they will be giving up control of their economic relations with the rest of the international community. To a certain extent, this is true. However, for oil producing countries whose main source of income is the export of oil, this should not be a big concern.

Section 4.1 introduced us to the four main rules of international trade. At this point, you should be able to articulate these four rules and explain briefly how they would apply in a hypothetical situation. Next, we will learn about some of the exceptions to the rules of international trade.

4.2 Exceptions to the Rules of International Trade

Under certain circumstances, a country may need to violate the rules of international trade. For instance, concerned about the health of its citizens, a country may ban the importation of a carcinogenic product. Similarly, a country may feel compelled to violate its international obligations in order to protect the environment. Foreseeing these situations, the drafters of the GATT inserted various provisions allowing countries to avoid the strictures of the law. This section will focus on the various ways in which a country may legally breach its obligations.

4.2.1 GATT Article XX

GATT Article XX lists instances where a country’s failure to act in accordance with its GATT obligations may be justified. Although Article XX provides a limited list of cases in which this is possible, the categories listed are broad enough to encompass a variety of factual scenarios. Notwithstanding its scope, justifications brought under Article XX are meticulously scrutinized by the DSB and are often unsuccessful. To date, less than 10% of all measures defended under an Article XX provision have been successful.

To survive scrutiny under Article XX, a measure must fulfill two discrete requirements. First, the inconsistent measure must be deemed necessary to further one of the purposes listed in Article XX. For instance, assume that Country X has just imposed a ban on the importation and

33 Id., at 529.
34 Id., at 535.
domestic production of unfiltered cigarettes for the purpose of “protecting human life and health.” On its face, this measure may be inconsistent with a variety of GATT obligations, including Article XI, Article III, and several others. However, if Country X can show that this measure is necessary to accomplish the goal of “protecting human life and health,” it may fulfill the first requirement.

The second step in assessing a measure under Article XX is to determine whether the measure was imposed in good faith and not for the purpose of protecting a domestic industry or discriminating between trading partners. This requirement is contained in the first paragraph of Article XX. The purpose of this paragraph is to prevent the abuse of Article XX exceptions. To pass muster under Article XX’s first paragraph, the DSB must determine that the measure is neither arbitrary nor unjustified and that in accomplishing its stated goal, it does not restrict trade more than necessary. If the DSB can articulate a less trade restrictive measure, or if it finds that the measure does not achieve its stated objective, then the measure may not be justifiable under Article XX.

4.2.2 Safeguards

In certain situations, trade can severely damage a domestic industry. For instance, assume that Country X, a leading producer of coconuts, has just come out of a terrible drought. The drought wiped out many of the country’s largest coconut producers, so domestic coconut supply is limited and prices are high. Now assume that the rest of the world has just had the best coconut harvest in recent history and has enough coconuts to satisfy world demand, including that of Country X. Country X’s citizens want coconuts, but they don’t want to pay high prices for them, so they begin importing coconuts from other countries. In fact, they import so many coconuts that it becomes almost impossible for domestic coconut producers to sell their own coconuts. The domestic coconut industry, an industry that previously employed 30% of Country X’s population, is in danger of being vanquished. Such a case calls for the imposition of a safeguard measure. Safeguard measures are “remedies that are imposed in the form of import restrictions in the absence of any allegation of an unfair trade practice.”

GATT Article XIX and the Agreement on Safeguards define and regulate safeguards. They stipulate that the following requirements must be met for the imposition of a safeguard measure: the circumstances triggering the safeguard must be unforeseen; the drastic increase in imports may be absolute or relative to domestic production; the increase in imports must either cause or threaten serious injury to domestic producers of “like” or “directly competitive or substitutable” products; and safeguards must be applied on an Most-Favored-Nation basis.

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4.2.3 Preferential Trade Agreements

With the WTO’s main goal in mind, specifically the liberalization of trade between countries, let us now turn to the case where countries decide to fully liberalize trade, but not on a Most-Favored-Nation basis. This situation may arise when two or more countries enter what is called a preferential trade agreement. A preferential trade agreement is one in which the parties offer each other more favorable treatment than that offered to third countries. Preferential trade agreements are overt violations of Most-Favored-Nation treatment, but allowable exceptions under the GATT.

Preferential trade agreements may take the form of free trade agreements. A free trade agreement is one in which the parties promise to eliminate all import tariffs and to allow the free flow of goods across their borders. The North American Free Trade Agreement (NAFTA) is an example of a free trade agreement. Preferential trade agreements may also take the form of customs unions. A customs union is the same as a free trade agreement, but with the additional stipulation that its members must jointly set import tariffs for the products of countries not involved in the customs union.

As explained above, the difference between a free trade agreement and a customs union is that in a customs union the members set a common tariff on goods from countries outside the customs union. For instance, Canada and Mexico, both members of NAFTA, are allowed to set their own tariff levels on imported cars. Conversely, France and Italy, both members of the EU, are obligated to have similar tariff levels on imported cars. By setting all tariffs at a similar level, exporters will not be incentivized to send all their goods through a single entry point and use that country as a base for all their trade with the rest of the customs union. Currently, Iraq is in the process of negotiating the Partnership and Cooperation Agreement Between Iraq and the European Union, which seeks to promote trade relations between Iraq and the European Union in line with WTO principles.

GATT Article XXIV defines and regulates the creation of preferential trade agreements. This article stipulates that a free-trade agreement that does not lead to the imposition of higher or more restrictive duties or regulations on non-member countries is consistent with GATT. This means that the creation of a free-trade area should not affect the tariffs that a member of the free-trade area imposes on non-member countries. Although inconsistent with Most-Favored-Nation treatment, it is acceptable because it does not unnecessarily burden the international trading system.

Article XXIV further stipulates that the duties and regulations imposed on non-members of a customs union “shall not be on the whole higher or more restrictive than the general incidence” prior to its formation. This means that the average tariff level may not be higher than it was before the creation of the customs union. Some tariffs may rise above previous levels, but on average they may not be higher than before the creation of the customs union.
4.3 Protection Against Unfair Trade Practices: The Case for Trade Remedies

This section will focus on the provisions of the GATT that deal with trade remedies. Trade remedies are tools that a country can use when it is detrimentally affected by the unfair trade practices of a third country. They differ from exceptions in that they are unrelated to the conditions prevalent in the importing nation.

4.3.1 Dumping and Antidumping Duties

Dumping refers to “the sale or likely sale of imported merchandise at less than fair value.”\(^{36}\) Article 2.1 of the Anti-Dumping Agreement provides that “a product is to be considered as being dumped...if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.”\(^{37}\) Essentially, this means that a producer who sells goods in a foreign market at prices lower than those at which the goods are usually sold in his domestic market, is dumping.

As is the case with precipitous increases in imports requiring safeguards, dumping can severely undermine the strength and overall existence of a domestic industry. In fact, that is the goal of dumping—to challenge a domestic industry for control of a market by selling merchandise at prices much lower than those at which the domestic industry can afford to sell its goods.

GATT Article VI defines dumping and provides a remedy for dumping, namely anti-dumping duties. Anti-dumping duties are taxes imposed on dumped goods with the purpose of raising their price in the importing market. If a country believes that it is the victim of dumping, it may levy an anti-dumping duty on the goods from a specific producer. However, it must first conduct an “objective examination” in order to determine whether or not its domestic market is being materially injured or threatened with material injury. Article 3.2 of the Anti-Dumping Agreement stipulates that an objective examination will look at “the volume of the dumped imports and the effect of the dumped imports on prices in the domestic market for products, and the consequent impact of these imports on domestic producers of such products.”\(^{38}\)

Once a determination of injury has been made, a country may impose an anti-dumping duty, but it must be limited to the amount of the dumping margin. This means that if a good is sold at a price 35% lower than that at which it is sold in its own market, the anti-dumping duty must not be higher than 35% of the value of the good in its own market. The reason for this restriction is

\(^{37}\) Anti-Dumping Agreement, Art. 2.1.
\(^{38}\) Article 3.1, Anti-Dumping Agreement.
that anti-dumping duties are not intended to have a punitive effect, but merely that of leveling the playing field for all producers.

4.3.2 Subsidies and Countervailing Measures

This section concerns subsidies and the remedies tailored to deal with them. A subsidy is a sum of money provided to a private party by the government—the goal of a subsidy is to lower the price of a good in order to help an industry become competitive. In response to a forbidden or specific subsidy—to be defined below—a country may impose countervailing duties on the goods of a specific producer. Countervailing duties are “special dut[ies] levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise.”

Only certain kinds of subsidies may be countered through the use of countervailing measures. The Agreement on Subsidies and Countervailing Measures identifies three types of subsidies. “Green Light” subsidies are those that offer specific forms of assistance for research activities, or to disadvantaged regions of a country—this kind of subsidy is explicitly permitted and cannot be challenged. “Orange Light” subsidies are those that are not automatically forbidden—they can only be challenged if certain conditions are met, particularly those pertaining to “specificity” and the potential to cause “adverse effects” to a country’s trading partners. “Red Light” subsidies are those tailored to increase exports and those contingent on an industry’s use of domestic goods—“Red Light” subsidies are forbidden.

To determine whether a countervailing measure is warranted, a country must first determine whether a subsidy exists. Article 1 of the Agreement on Subsidies and Countervailing Measures provides us with a definition of a subsidy. Upon determining that a subsidy exists, a country must determine whether the subsidy is “specific” as defined in Article 2, or forbidden as defined in Article 3. All forbidden subsidies are specific. If a country finds that one of its trading partners is in fact providing a specific or forbidden subsidy, it may either impose countervailing measures or bring a case before the DSU.

Even after a specific or forbidden subsidy is identified, a country may not impose a countervailing duty unless it suffers injury or a threat of material injury, nullification or impairment, or serious prejudice to a domestic industry.

A country wishing to vie for control of the international market may prefer to bring a case before the DSU. Such an action would lead to the repeal of the subsidy. A country only wishing to protect its domestic industry might choose imposing countervailing measures, given that they do not require WTO approval to do so and their effect is immediate.

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39 GATT Article VI:3.
We have now finished our analysis of the GATT. The next section will briefly address the General Agreement on Trade in Services. In doing so, it will familiarize you with the overlap between the liberalization of trade in services, and the liberalization of international investment.

5 MOVING BEYOND TRADE IN GOODS—TRADE IN SERVICES AND THE RELATIONSHIP BETWEEN INTERNATIONAL TRADE AND INVESTMENT

This section will address the overlap between international trade and international investment by means of a brief analysis of the General Agreement on Trade in Services (GATS).

The General Agreement on Trade in Services (GATS)—introduced earlier—is “a set of general rules that apply across the board to measures affecting trade in services, and sector-specific commitments on market access and national treatment.” It addresses four different types of service provision: cross-border, consumption abroad, commercial presence, and presence of natural persons.

Cross-border service provision occurs when a service supplier in one country provides a service in a second country—for instance, many phone companies are cross-border service suppliers. Consumption abroad occurs when a consumer from one country travels to a separate country to consume a service—this often occurs with medical services. Commercial presence is when a service supplier from one country establishes a commercial presence in a second country—a good example of this would be the presence of an accounting firm or a law firm in a third country. The last, presence of natural persons, occurs when a service provider, be it a doctor, an accountant, or a lawyer, travels to another country to provide a service.

Given that the GATT’s underlying principles are also present in the GATS, international trade in services has greatly increased since its ratification. Moreover, it has led to the progressive liberalization of investment laws, particularly due to modes three and four—commercial presence and presence of natural persons. In order for a company or an individual to be willing and able to establish a presence in another country, that country’s investment laws, as well as the international laws it is obligated to abide by, must be flexible.

The increased importance of the international trade in services has brought the WTO into the sphere of international investment. This sphere, however, already has other important players. The International Center for the Settlement of Investment Disputes (ICSID) has been around for

41 Guzman & Pauwelyn, pg. 598.
almost fifty years, and many regional trade agreements include provisions dealing with the settlement of investment disputes. Needless to say, the field of international investment is crowded.

Increasingly, disputes arise containing issues pertaining to trade and investment. In the face of such complexity, scholars contend that a common alternative is to allow these issues to be resolved within the dispute settlement bodies of preferential trade agreements. By doing so, the jurisdictional issues born of the overlap between the WTO’s jurisdiction and that of another body, are eliminated. Whether or not this trend will continue depends on the WTO’s ability to acclimate to the new international business climate. In a system governed by the consensus of its members, this may be easier said than done.
6 Annexes

Annex 1

WTO structure
All WTO members may participate in all councils, committees, etc, except Appellate Body, Dispute Settlement panels, and plurilateral committees.

Ministerial Conference

General Council meeting as Dispute Settlement Body

General Council meeting as Trade Policy Review Body

Appellate Body
Dispute Settlement panels

Committees on
Trade and Environment
Trade and Development
Subcommittee on Least-Developed Countries
Regional Trade Agreements
Balance of Payments Restrictions
Budget, Finance and Administration

Working parties on
Accession

Working groups on
Trade, debt and finance
Trade and technology transfer
(Inactive: Relationship between Trade and Investment
(Interaction between Trade and Competition Policy
(Transparency in Government Procurement)

Council for Trade in Goods

Council for Trade-Related Aspects of Intellectual Property Rights

Council for Trade in Services

Plurilaterals
Trade in Civil Aircraft Committee
Government Procurement Committee

Doha Development Agenda:
TNC and its bodies

Trade Negotiations Committee

Special Sessions of
Service Council / TRIPS Council / Dispute Settlement Body / Agriculture Committee and Cotton Sub-Committee / Trade and Development Committee / Trade and Environment Committee

Negotiating groups on
Market Access / Rules / Trade Facilitation

Plurilateral
Information Technology Agreement Committee

Key

Reporting to General Council (or a subsidiary)
Reporting to Dispute Settlement Body

Plurilateral committees inform the General Council or Goods Council of their activities, although these agreements are not signed by all WTO members

Trade Negotiations Committee reports to General Council

The General Council also meets as the Trade Policy Review Body and Dispute Settlement Body

Last printed 31/03/2006 3:01 PM
7 Glossary of Terms

A

Absolute Advantage: An absolute advantage exists when one country is better than another country in the production of a certain good or category of goods.

Accession: Process by which a country becomes a Member of the World Trade Organization.

Ad Article: Explanatory note provided by the drafters of a treaty to clarify the purpose and intended interpretation of a specific treaty provision.

Ad Valorem Duty: Importation taxes, or tariffs, equal to a certain percentage of the value of a good.

Anti-dumping Duty: Taxes imposed on dumped goods with the purpose of raising their price in the importing market.

C

Comparative Advantage: A situation in which a country has “a greater margin of superiority or a smaller margin of inferiority” in the production of a good.

Contracting Parties: Name given to the signatories of the General Agreement on Tariffs and Trade during its period of provisional application.

Countervailing Duty: Duties levied for the purpose of offsetting the effects of a specific of forbidden subsidy.

Covered Agreements: The agreements included in Annex 1 of the Marrakesh Agreement Establishing the World Trade Organization (WTO Agreement)—they form an integral part of the WTO Agreement and apply to all of its Members.

Customs Union: A preferential trade agreement in which the members jointly set import tariffs for the products of countries not parties to the agreement.

D

Dumping: The sale or likely sale of imported merchandise at less than fair value.

E
**Exportation:** The act of selling domestically produced goods to international consumers.

**Factors of Production:** The resources used to build an economy and produce goods and services; they are land, labor, and capital.

**Free Trade:** Trade without any form of barriers.

**Free Trade Agreement:** A preferential trade agreement in which the members pledge to eliminate import tariffs on all trade between member states, and to allow the free flow of goods across their borders.

**Goods:** Items or materials produced, consumed, and traded in an economy.

**Importation:** The act of purchasing goods from a foreign country in order to sell or consume them domestically.

**Infant Industry Argument:** An argument in support of protectionism, based on the idea that without protection, a young domestic industry will never be able to thrive and grow.

**Internal Regulation:** Regulations applied to a product after it has crossed a country’s borders.

**Internal Taxation:** Taxes applied to a product after it has crossed a country’s borders.

**International Trade:** The sale and purchase of goods and services across international borders.

**Liberalization:** Progressive reduction of barriers to trade.

**Most-Favored-Nation Treatment:** A subset of the principle of non-discrimination based on the idea that every WTO Member should treat each of its fellow Members equally.
National Treatment: A subset of the principle of non-discrimination based on the idea that a country should treat imported goods the same way as it treats domestically produced goods.

Power-Oriented System: A system in which all relations between members are fully controlled and guided by the regime’s members; some members have more power than others, and thus receive better treatment within that system.

Preferential Trade Agreement: An agreement in which parties offer each other more favorable treatment than that offered to third countries.

Protectionism: The practice of preventing or limiting international trade with the ultimate goal of protecting domestic producers.

Quota: A limit imposed on the quantity of a good that can be imported into a certain country.

Rule-Oriented System: A system in which all relations between members are fully controlled and guided by a discrete set of rules; these rules apply to all equally.

Safeguard Measure: A trade remedy imposed in the form of import restrictions in the absence of any allegation of an unfair trade practice.

Services: Intangible goods such as banking services, cellular phone service, etc.

Specific Duty: A tariff that does not depend on the value of a good, and is instead imposed on a per-unit basis.

Subsidy: A sum of money provided to a private party by the government—the goal of a subsidy is to lower the price of a good in order to help an industry become competitive.
**Tariff:** A special tax imposed exclusively on imported goods.

**Trade Remedy:** Tools that a country can use when it is detrimentally affected by the unfair trade practices of a third country.

**Treaty:** A deal or agreement made between countries.