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**Market Access in the GATT**

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# MARKET ACCESS IN THE GATT<sup>1</sup>

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## **Abstract**

While many think that one of the main feature of WTO's action is its de-regulatory effect, this lecture aims to demonstrate that since the adoption of GATT 1947 regulatory diversity has always been conceived as a non-negotiable value. The judges in the WTO system have the duty to fill the gaps of an incomplete contract, hence the importance of their role and the risk connected to their possible mistakes. In this sense, new generation agreements such as the TBT and the SPS introduce a more detailed test to discover protectionist measures: their adoption support the difficult task of the judge, while their demanding terms risk to endanger developing countries' market access. Harmonisation through rules is still a non-feasible objective, but the legislation has undergone a material improvement, and should foster liberalisation without prejudice to domestic policies.

## **Keywords**

WTO, GATT, TBT, SPS, trade liberalisation, market access, regulatory diversity, Dispute Settlement Body, non discrimination, domestic policies

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## MARKET ACCESS IN THE GATT

*Lecture held at the Sant'Anna School of Advanced Studies on May 25, 2007*

**Petros C. Mavroidis<sup>2</sup>**

Summary 1.- Introduction 2.- The role of tariffs in the GATT and the negative integration process. 3.- Non discrimination and protectionism in the GATT framework. GATT as an incomplete contract. 4.- The new generation agreements. A step towards contract's completeness 5.- The judiciary of the WTO. The need for transparency. 6.- Final remarks

### **Introduction**

How is liberalization developed in the GATT?<sup>3</sup>

Let's start by saying that the GATT formula is an imperfect one: it suffers from birth defects, and suffers also from the very subject matter of the GATT: it is a rationally incomplete contract, whose incompleteness has serious repercussions on trade liberalization.

This contractual incompleteness I mentioned is nevertheless a *passage obligé*: WTO were aware of the risk of relying on an incomplete treaty; the point is that case law, if possible, made things much worse, as I will try to explain.

Finally, I will show how the new generation agreements, TBT<sup>4</sup> and SPS,<sup>5</sup> have addressed the situation much better than the GATT.

### **The role of tariffs in the GATT and the negative integration process.**

You will not find the words "market access" anywhere in the GATT, they just do not exist; however, all of the GATT is about market access, it states the rule according to which trade across different nations is opened up. Furthermore, there is one political decision in the GATT, as it does not deal with private practices, it focuses on governmental practices: private business practices must be treated in accordance with domestic competition laws, they are not covered by the GATT.

Before we discuss the main elements, I think there are some things, which are very

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<sup>3</sup> General Agreement on Tariffs and Trade.

<sup>4</sup> Technical Barriers to Trade Agreement.

<sup>5</sup> Sanitary and Phytosanitary Measures Agreement.

important to make clear. The first one regards the second point I made before, the simile with the incomplete contract.

When the GATT was negotiated, in the 40's, the economic thinking was very developed, for instance they knew very well the equivalence proposition.

Just to remind you what equivalence is about, I will give you an example: any time Italy imposes a tariff of 20% on the import of bottled water from Switzerland, Swiss water becomes more expensive for the Italian consumer. Now, this is good news for Italian producers, because they have less competition, but bad news for Italian consumers, as they pay more for the same product.

Then, what is a tariff? It is a subsidy to producers and a tax on consumers: now we understand how the equivalence works: every trade instrument can be decomposed or transformed into an equivalent domestic instrument.

When you look at the negotiation of the GATT you will be surprised to find out that the best economics' minds participated in the negotiation: Keynes, Meade (Nobel 1977), Robbins, Amery, Dalton, Hawkins.<sup>6</sup> These guys knew *ex ante* they had to impose disciplines on every instrument, otherwise they would have never achieved their objective. The problem was obviously to understand when to stop in this incredible regulating effort. It is impossible to think of an instrument that does not affect trade, let me just prove it through a very unrealistic example: let's suppose that one of the students in this room becomes the dictator of Italy, a natural consequence of such a state of dictatorship would probably be the disappearance of any freedom of expression, this meaning papers are not a relevant market any more, and thus the import of newspapers is blocked. As you can see, it is impossible to think of an action which does not affect trade.

There is no *Keck* equivalent in the GATT – WTO framework. *Keck* was a very famous case in the 90's<sup>7</sup> where the European Court of Justice said that some policies which very indirectly affect trade are left out of the application of Art. 28 of the Treaty (now Art. 30), which is the equivalent of Art. III of the GATT.

Another thing to bear in mind is the peculiar nature of the disciplines in the GATT. When you look at the EU in 1957, it consisted of six states that were somehow similar: it is very easy for a group of countries like this to think of common goals; they are like-minded, they are thinking the same way. Now, if you think of the WTO system, there were 23 GATT Parties in 1947: some of them were countries like the United States, the United Kingdom or the Netherlands, other were States like Syria, Lebanon and India. This was not a homogenous group of nations, so it was very difficult for them to consider harmonized policies; this was a material constraint in their negotiations.

<sup>6</sup> Cfr. <http://www.dartmouth.edu/~dirwin/Creation.pdf>.

<sup>7</sup> Joined Cases C-267 and 268/91 *Keck and Mithouard* [1993] ECR I-6097.

We have cleared so far that every policy implies a trade effect, and that it was difficult to find a common ground in order to adopt common policies, through intergovernmental diplomatic negotiations: so GATT, by definition, had to be a *negative integration* scheme. By negative integration system here we mean an order in which no harmonized policies are set, and a sole obligation stands on the actors, the non-discrimination one. In this scheme all instruments are freely eligible, including protectionist policies, but they are inevitably bound by the non-discrimination obligation, and we cannot move towards positive integration. By avoiding the construction of common policies, we essentially admit that there is no guarantee for market access.

Think of it this way: there is an Italian regulation requiring catalytic converters on cars. Pakistan law does not foresee a similar provision, but nevertheless Pakistanis want to sell their cars in Italy. Non-discrimination means also that Italy can forbid the sale of imported cars without catalytic converters: importers to Italy have to comply with the same internal regulations imposed on Italians retailers.

There is no (automatic) guarantee for market access.

Let's turn to a useful classification, before organizing the said above into a homogenous set of thoughts: a trade instrument is an instrument, which affects tariffs and quotas, either domestic or foreign, but not both simultaneously. The domestic instrument by definition affects both.

There are essentially three trade instruments: tariffs, import/export quotas, and export subsidies. I do not refer here to domestic subsidies, because domestic subsidies can be granted on foreign products as well, they are not necessarily related to non-discrimination. How does tariffs work in the GATT? Let me make one big lesson here, let me show you that *we don't need to care very much about tariffs in the GATT nowadays in 2007*, and we will see why. Tariffs will be distinguished between *default* and *state contingent* tariffs. What is a default tariff?

Italy can, for example, import cars from Pakistan at a 10% import duty: that's the default tariff. As for state contingent tariffs, they are triggered at the occurrence of a chosen event: if something happens the tariff will be increased. This 'something' has been contracted in the agreement. Let's take dumping, for example. If Pakistan dumps, Italy will add the amount of dumping to the tariff. So if I get 10% value, and I fine for dumping at 20%, 10 plus 20, that's 30%. But crucially, I cannot import this 20% unless the contingency occurs, hence the 'state contingent' denomination. Similarly, if Pakistan subsidizes, I will add the amount of subsidy to the tariff. So, for example, if

So there are three contingencies: antidumping, countervailing measures and safeguards, but we do not need to analyze them in-depth. Default tariffs can be categorized as well: there are MFN tariffs

(e.g. Italy imposes a 10% tariff on cars from the rest of the world)

and preferential tariffs. These latter could be neutral Preferential Trade Agreements or measures designed for helping developing countries - a subset of the WTO membership – such as the GSP's.

(e.g. Italy imposes a lower tariff, so as to give an advantage to developing countries: if the tariff applicable to US cars is 10%, Pakistan might pay 5%)

When it comes to quantitative trade restrictions, the discipline is much more harsh. All import and export quantitative restrictions are illegal, you cannot have import and export restrictions. You can have domestic quotas, like OPEC has (domestic quotas on the production of oil), but you cannot have import and export quotas. If information about supply, demand, and price, and tariff are available, any tariff can be expressed in quota restrictions' terms, and *vice versa*;

if I know for example the equilibrium price in Italy, and the supply from the rest of the world, I can easily draw an equivalence: a 10% tariff on cars equals, let's say, to 15,000 imported cars.

Why then does the GATT prefer tariffs rather than quantitative restrictions? The answer here is very sensible: when you impose quantitative restrictions, you add a series of negative external effects. A tariff is a tariff: it tells you the added percentage on the price of imported products, and that's all. But when you have quantitative restrictions somebody has to make sure that the quota has been respected, you need to set up a customs' office, this is a first burden. States would tend to impose a quota on products which are very competitive:

for instance, if there is a very high Italian price and a very low world price, a State will then provide for equal prices, and will then try to benefit from the difference.

These are just a few examples among a series of issues that go hand in hand with quantitative restrictions, just to show why quota restrictions are illegal, and tariffs are preferred. Now, all import/export quota restrictions are illegal, see Art. XI GATT. Export subsidies, as well, are completely illegal. What is the conclusion here? I mentioned three things, tariffs, quota restrictions, and export subsidies. Only one can be used, that is tariffs. You cannot use export subsidies, if you play the game properly, you cannot use quantitative restrictions. So the only way through which a WTO member can protect its own welfare is tariffs.

What happens to the domestic instruments? Remember what we said before, the players in the original GATT were drawn from a non-homogeneous group, and this situation has worsened now with the WTO, whose membership equals to over than 175 countries. The GATT discipline is non-discrimination, which means that anyone is free to reveal a

preference, whatever it is, environmental, public policy, health, competition, and then once we reveal a preference, which is unilaterally defined, then you apply it in a non-discriminatory manner. That is what we meant by negative integration. Let's take this example of the catalytic converters again.

If Italy demanded that every car in Italy had to carry a catalytic converter, claiming for instances that cars without catalytic converters are one of the causes of the acid rains, the Italian Parliament adopts a statute in this sense. Now, this Italian law has one objective, which is the protection of the environment, but there is an external effect as well, and this effect is negative to Pakistanis cars' manufacturers that cannot export cars to Italy. Thus, the Italian measure, which aims at the protection of the environment, has a negative external trade effect.

What is the GATT's philosophy? The negative external effect is fine *as long as* Italian law is applicable on Italian producers, so what is the internalization of the externality? It is the non-discrimination result. If we do not discriminate, we can ignore the external effect, this is the GATT recipe. Policies are being unilaterally defined and, to the extent that there is an international spillover, it will be internalized through non-discrimination. Of course, when you conceive negative integration in this way, you accept *ex ante* this phenomenon of regulatory diversity, you accept to live in a world with different societal preferences. ***Trade will not harmonize societal preferences.*** Trade is not the over-arching value in the WTO contract. ***Trade comes after respect of regulatory diversity.*** Nobody can force Italy to import environmentally polluting cars, as long as Italy imposes environmental legislation on its own producers. So first comes social preferences, then comes international regulation. But of course negative integration and regulatory diversity, which is the conclusion of negative integration, are not beneficial to market access.

Let's think for a moment to the *Cassis de Dijon* case decided by the European Court of Justice.<sup>8</sup> The Court said that Europe should be, at least in principle, a mutual recognition area. What does this mean? It means that a Member State can stop imports of products, which are legally produced in other countries, only if they go against our public order. Is this possible?

If "*pecorino sardo*" is legally produced in Italy, it will go throughout the 27 countries without meeting any obstacle, and Bulgaria could, for instance, block the import of "*pecorino sardo*" to Bulgaria, by saying that it would jeopardize its public order, but it ought to better try and find a very good excuse before the European Court of Justice, to justify its choice in this sense.

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<sup>8</sup> Case 120/78, *Cassis de Dijon* [1979] ECR 649; [1979] CMLR 494. A similar situation occurred within the Italian system, as regards to the production of "*aceto balsamico*".

Mutual recognition is in principle a guarantee for market access because, always in principle, everything would circulate freely across the Community.

In the WTO, instead, we do not have mutual recognition. As we stated before, the GATT's recipe is non-discrimination, and negative integration. Whilst you have market access in Europe, you do not necessarily have it in the WTO. We have seen so far the trade instruments and we have seen the domestic instruments. How can we conclude very quickly? Well, first of all, when it comes to all domestic instruments, the conclusion can be very simple, because two out of three trade instruments are prohibited, there is only one way you can protect your national welfare in the WTO, that is through tariffs.

But tariffs, I want to caution you, are a fading factor: every now and then there is a playground where people negotiate tariffs, they have gradually been reduced, and eventually they will be 0%. So when tariffs are out of the place we will live in a world where the only barriers to trade will be regulatory barriers, *i.e.* domestic instruments. I suggest that from now on we discuss just domestic instruments, because ***tariffs are relatively unimportant.***

Especially if we look at the two big markets, EC and US, most of the tariffs are 0%, the average level is 4.25%. There are of course two tariff peaks: agricultural products and textiles: they are on average [before the Doha Round] between 15-20% in the EU, and between 20-30% in the US. As for farm products, Europe has kept enormously high tariffs, so far, but again, we can expect that through negotiation we will get to a situation where there will be no tariff above 75% If you look at tariffs nowadays you see tariffs of 300 or 400%, for some products, that's not because of Italy but because of the country next door, France. But as I suggest, because the farm trade as well is getting now streamlined you can forget about tariffs. Tariffs will become gradually unimportant.

***Non discrimination and protectionism in the GATT framework. GATT as an incomplete contract.***

***We should concentrate on regulatory variety***, investigating how trade is blocked through domestic instruments. Now remember what we said before, that Italy can block trade from Pakistan any time a Pakistani product does not conform to the Italian public order. Domestic law is not negotiable: political parties discuss an issue in the Parliament, and once it adopts an act of domestic law, this latter is not negotiable.

But here is the twist. You see, remember what we said: as long as Italy does not discriminate, there is no problem. ***But non-discrimination is not the end in the GATT, non-discrimination is the means. The objective is no protection.*** The objective is that you can protect your market only through tariffs, and this means that we should not be protecting the market through any other means, including domestic instruments. To make



this point perfectly clear, the GATT parties adopted Art. III.1 of the GATT, where there is a very clear acknowledgment of this principle: “*The contracting parties recognize that [internal measures] should not be applied to imported or domestic products so as to afford protection to domestic production.*”

Now we can ask an interesting question, whose importance does not depend on the answer that I am going to give: does non-discrimination, as a practice, reach its intended objective?

I will now try to rephrase the question and put it in the context of contract theory. What are the issues when two people negotiate a contract? The first point when we discuss domestic regulations is the one that we have discussed before, that of contractual incompleteness. When we negotiate a contract, we must bear two parameters in mind: one is the quantity of information that we want or we can put into the contract, the other is our level of ambition (let’s assume we can quantify the ambition); there is in principle a correlation between the two, in the sense that the more information you get in the contract the more ambitious the contract is, because you have thought of all possible outcomes in the future.

For example, if you want to sell a car to a Sicilian, or to buy a car from a Sicilian, no matter what the seller tells, the car could be a catastrophe, That is the reason why you would prefer to write down all possible contingencies; and if you write down a *complete contract*, in case something went wrong, the consequences would be regulated by the contract itself.

The more complete the contract, the more ambitious the outcome. In the real world, we do not need to think too much about details to include in the contract, when we act in the domestic (law) field: in case a dispute arises, you are most probably going to be taken to court, and even if the contract does not say anything about that particular event that occurred, you will get default rules, and a judge will decide to apply the Italian law, which is the default law.

In the international law system, those default laws are unknown, and that is why in international law and international contracts, we don’t give this luxury. We must put as much information in the contract as possible. The founding fathers of the GATT were well aware of that. They knew they had to foresee and write down a number of pieces of information in the contract, as, otherwise, its level of ambition would have suffered a material decrease. If every State demanded to contract in every domestic law in the GATT agreements, the situation would have turned ridiculously unbearable, and negotiations would have collapsed: every State could have provided thousands of acts of laws whose content they deemed relevant enough to be included in the contract. And even in such an utopian hypothesis, problems would have arisen quickly, as these laws are subject to change, and governmental preferences change as well, then such changes would have

implied further negotiations. So here comes the major constraint, represented by the amount of negotiating costs that a similar scenario would imply.

The only rule, as we said before, is the non-discrimination principle. Non-discrimination, accompanied by a general lack of information about every State's policies: we have uncertain and non-specific information about environmental laws in one member State, and this State can choose how to act, when dealing with its environmental interests, if it decides to adopt environmental laws, it is fully entitled to do that, and to keep them and to demand their respect; but any time a State feels it has a certain preference, and wants to set it unilaterally, it has to make sure that this is non-discriminatory.

When you say that the contract is incomplete, somebody has to complete the contract. Who will complete the contract? In the WTO it is clear - the judge will. The WTO contract is very different from any other international contract in one respect, as it provides compulsory third-party adjudication. If we, the EU, want to take the US to court, we don't have to request a consensus from US, we just take them to court. Now, what does the judge have to do? The judge has to perform a test, to verify to what extent, non-discrimination has achieved non-protection.

How would the judge do that?

Let's take the catalytic converter example back: Italy wants to impose catalytic converters on cars. There is an asymmetry of information here, because the regulator (Italy) has a set of private information, namely it knows why it has enacted that regulation. The trading partner, Pakistanis, on the other hand, do not know them: all they know is that Italy demand catalytic converters, as a requirement to export to Italy.

The regulator, besides owning exclusive information, has a very strong incentive to act in an opportunistic manner.

Now what do I mean by opportunistic? Self-protection interventions for legitimate public policy goals. Why do States have this incentive? Because if they demonstrate that their measure is not protectionist, they are offered a safe harbor, they cannot be accused of infringing Art. III.1 GATT. As the only subject who knows the truth about the rationale supporting the adoption of the domestic act is the same which is then asked to tell it out, there is a strong incentive, whatever the real reasons could be, to declare that the measure has been taken for the sake of public policy, or for the protection of health, or of the environment; admitting the protectionist intent would mean accepting the responsibility, and being exposed to the payment of a fine.

We must design the best, but we must separate the wheat from the chaff, that is, what is protectionist and what is non-protectionist. And what I would like to show you is that case law has not helped much: there is nothing like a test to rely on. By test I mean something that rests on a theory, and by theory I mean a thought experiment which can predict future behaviors. Tests, as obvious, are reliable when they will always give the same result, no

matter what the subject at stake is.

We have an incomplete contract, with private information, incentive to be opportunistic, and the judge does not know if a State is telling me the truth. Let me give you this example, the example of the cars. We will see what the case law has done in this respect.

When you say, “don’t discriminate”, what does non-discrimination mean? It presupposes some comparability between factual situations.

Namely, we must be sure that two products are treated in a non-discriminatory manner, when they are alike: in order to do so, we need to recognize like-products, that is we have to use a reliable criterion of likeness.

Back in 1947, when the ITO Agreement was negotiated, the Parties were conscious that among the other things an agreed notion of likeness was to be found, but as the US Congress decided not to vote the Havana Charter, the project was obviously blocked, because it was impossible to conceive a trade global agreement without the US participation. Thus, the parties did not interpret the term “likeness”, and it could be interpreted only by subsequent adjudication.

In particular, we have to take a look at the report issued by the GATT Panel, in the case *US – Taxes on Petroleum (Superfund)*.<sup>9</sup> This report is the mother of all disaster, as I will try to show you.

The US taxed domestic petroleum substances less than foreign petroleum. As for taxation (which is one of the domestic instruments), the GATT prohibits the application on foreign products of taxes that are higher than those applicable on domestic ‘like goods.’ The Panel just verified the difference between tax rates, and consequently condemned the US, without investigating the meaning of “likeness”, and without checking whether such a tax differential actually amounted to a protection measure.

In brief, the first case on this issue failed to address the problem properly, and introduced a sort of presumption, according to which every time discrimination occurs, protectionism follows automatically. We can see in such a case law a confusion between the ends (non protectionism) and the means (non discrimination).

This report did not ask the question, maybe because the US did not defend its position at all; and after this report, in every report from the GATT panels, every time a tax differential was at issue, the conclusion was that the discriminatory measure implied protectionism. This interpretation goes against the whole spirit of Art. III, pursuant to which interventions are not prohibited (domestic regulations, even applied in a discriminatory manner), they are permitted *as long as they do not trigger protection*.

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<sup>9</sup> *United States – Taxes on Petroleum and Certain Imported Substances*, June 17, 1987, GATT B.I.S.D. (34th Supp.). Available at <http://www.worldtradelaw.net/reports/gattpanels/superfund.pdf>.

There is only one subset of regulations that is illegal: protectionist regulations.

If we follow instead the ratio of the *Superfund* panel, we end up saying that every time consumers think that the products are alike the government cannot intervene (let's just mention that the case law stated that likeness depends on the consumers' taste); there would be no room left for regulation, following this no-effects, no-intent test.

But the governments intervene precisely because it might put private information about the issue the consumers have no idea about, consumers' taste can be superseded by a public need, or a public reason, and that explains the existence of any public policy exception.

For instance, it could be that the Italian government knows that Italian citizens have access to a kind of beef meat, which has undergone a particular treatment during its production, and which could cause a disease. The government will intervene when consumers have not internalized the externality enshrined by the product, whatever it

The construction used in the *Superfund* panel, instead, leads to a reduction of the government's role to zero. This is incorrect, to the extent it neglects the distinction between the effect of a domestic measure (which is discriminatory) and its intent (which could be non-protectionist); and to know the intent of the subject adopting a measure you have to ask him questions. A consistent test of compliance with Article III GATT should depend on the evaluation of both the intent and the effect of the measure adopted. The test introduced in 1987 was, instead, a *pure de-regulation* device.

This criticism we have just expressed has traditionally found a precise answer. Part of the doctrine is not worried by this indiscriminate de-regulatory effect we have denounced, because, they say, a national measure could survive this strict test by invoking one Art. XX GATT exception. Thus, the strictness of the Art. III test, as construed in the *Superfund* report, would not have unreasonable effects, as long as measures provided with a real interest basis are saved by Art. XX GATT.

This argument could be somehow intuitive, but it is misleading: Art. XX GATT<sup>10</sup> is based on the principle of non-discrimination as well, as it was the case with Art. III. Therefore, we cannot rely on Art. XX as an effective exception to Art. III, at least we would find it quite difficult to demonstrate that the same measure is discriminatory under Art. III and non-discriminatory under XX.

How can this be possible? If we take a look at the first draft of Art. XX we see that it encompassed an exception to two articles only, Art. II and Art. XI GATT, which regard

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<sup>10</sup> Whose first paragraphs reads: "*Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures [described as follows].*"

those instruments that are discriminatory by definition: *i.e.* trade measures; domestic instruments were not contemplated.

In the context of Article III, to conclude, the judge must inquire into the regulatory intent, even though it is difficult to get a certain result, as the subject knowing the real motivation of a measure sometimes is the same subject having an interest in hiding this information; if this test is carried out correctly, within a reasonable margin of approximation, a domestic regulation is saved by the Art. III provision, and does not need to resort to the general exceptions of Art. XX.

### **The new generation agreements. A step towards contract's completeness**

Let us turn now to the SPS and TBT agreements.

These are contracts in the GATT, which regulate a subset of domestic instruments, for example instruments regarding the trade of GMO's are regulated by the SPS agreement. What are the peculiar features of the SPS? Let's analyze it briefly; it is important to be conscious how these new generation agreements are drafted. SPS asks the same question asked by the GATT: firstly it makes sure that domestic instruments adopted for protectionist purposes are ruled out. Besides this, SPS adds a series of criteria to understand what the real motivation of the domestic discriminatory legislation. As you can understand, this kind of contract is slightly more complete than the GATT, it is more ambitious than the GATT; and it is an obvious evolution, that is based on the experiences of the last sixty years. Being more ambitious, this contract reduces the potential for an error by the judge.

First of all, under the SPS agreement measures must not only be non-discriminatory, but if there is an international standard, it must be used.

For example, if the ISO (the International Standards Organization) decides that catalytic converters are necessary to reduce pollution caused by cars, and that they represent the agreed means of fighting pollution, if such an objective is the same that has motivated the Italian internal regulation, then Italy, in principle, ***can use only this standard***, to achieve its purpose.

Why is this a step away from protectionism? You can imagine that when Italy and Pakistan, or the US and the UK or any other country meet to establish common standards a discussion carried out within an international organization could be the ideal means to achieve a regulatory objective. This is because in a similar forum the participants are not interested in drafting beggar-thy-neighbor mechanisms, in principle they are disposable to agree a policy that is acceptable to everybody irrespective of its trade costs.

Our regulatory objective is to contrast acid rains, for example. So there is some sort of presumption that the standard genuinely goes in favor of combating acid rain, rather than in favor of each state's interest.

Why do we need this additional condition (the conformity with standards)? In economic theory there is nothing like an off-the-shelf definition of the term protection.

To compensate for this lack of definitions, we can entrust our efforts to other reliable parameters: firstly, a standard agreed by a worldwide consensus tends to be more difficult to be used as a protectionist device; secondly, the use of scientific expertise guarantees a non-local point of view.

For instance, if Italy demanded that all cars must carry a catalytic converter to contribute to its policy against pollution, and there were scientific evidence proving that Italian catalytic converters do not combat pollution at all, then Italy could not block the import of cars without catalysts from Pakistan under the SPS agreement.

Only the referral to a widely agreed standard can legitimize the adoption of a restrictive domestic measure.

In addition, *all SPS measures must be necessary to reach stated objective*. Now what does necessary mean? This request entails a general principle, stating that States must impose the lower possible cost on international transactions. Why is this a principle against protectionism? In principle, if I wanted to protect my market I would prefer to impose the maximum cost to foreign producers, not the minimum cost. If you impose on me the minimum cost by definition I move away from my objective to protect domestic producers. Therefore, you can reasonably presume that necessary measures are measures aimed at achieving certain policies, rather beggar-thy-neighbor policies.

Finally, coherence is required. What does coherence mean here? Essentially, a State must demonstrate to have established a comparable level of, let's say, environmental protection across different rules.

So if Italy has a general regulatory coherence (as regards to the protection of the environment), and adopts a statute that limits the import of polluting cars from Pakistan, you can presume that Italy is not aimed at protecting domestic producers, because the single measure is part of a genuine and coherent environmental approach.

These proxies, next to non-discrimination, will reduce the risk of the judge making an error when he decides about the protectionist nature of a domestic measure. If I impose a huge cost on my producers, again, how could I be accused of protecting them? How can I favor my domestic industry if it has to incur the same adjusting costs?

So again when we impose this cost on domestic producers' welfare there is at least a presumption that we are going to want to act in a protectionist manner. According to my

views, Art. XX should be the exception to Artt. II and XI only; otherwise, if you want to view Art. III as a *continuum* with Art. XX, what I would suggest is to allocate the burden of the proof on who has the information. Remember, this is where we have to clarify both the effects and intent of a single measure. As regards effects, for example, who is best placed at discussing effects? The trader. Who is best placed at discussing intent? The regulator.

I am not saying that because this type of demanding legislation is costly for some we should not be regulating. Because, I tell you, I believe in free trade but I also believe in the solidity of public regulations. Therefore, I believe that free trade is not a value in itself, although I am a free-trader. Free trade is a means to become wealthier, and this can mean a better financing of my societal values. Free trade is just a means to have more money, to enhance the pie; I would like to see the pie distributed. Now I need to make another point, just show how things continue to be difficult to construe, and to avoid that you think that the picture is ideal.

Overall, the situation is a bit better now, with the new generation agreements, but still this improvement has not come without a cost. And whose is the cost? Developing countries have to pay the cost for this improvement in drafting and writing the agreements.

It is often said that we live in the era of de-regulation, but this is completely false: the overall amount of regulations into force now is tenfold the size of ten years ago. This is an obvious consequence of the progress of our knowledge in many fields: the more we know about risks and dangers, the more we regulate. By regulating more, as it is natural, we impose more and more costs over traders. So, essentially, the more demanding the legislation, the more costly it is. When we say public health or environment, and we fix certain standards to attain, they work as fixed performers, and they determine a cost that the producers must internalize, if they want to continue producing, whilst complying with the public-set policy. Producers from developing countries are not able to follow these new demanding conditions.

This phenomenon has been studied by researchers, which based their survey on empirical records.<sup>11</sup> If we take EU and US health and safety regulations, and we try to find out what impact they had on developing countries' export incomes (through a *before – after* comparison) the conclusion is quite simple: nowadays these countries cannot export as many farm products as they did before, and to a large extent this is due to the SPS conditions.

I am not saying we should not protect because of that. Now the question is, as you know, that the devil lies in the details. It depends on how you formulate the legislation that demands higher standards to attain your public purpose. Let's make an example:

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<sup>11</sup> Henson, Spencer and Wilson, John S. (eds.), *The WTO and Technical Barriers to Trade*, Elgar, 2006.

Italian law could just ask for ‘*catalytic converters*’ or, instead, it could ask for ‘*catalytic converters that guarantee that the emission of CO2 will not be higher than a certain value.*’ When norms start getting so precise, then the question is again: is this a legitimate measure or a protectionist measure? Let’s suppose for instance that Italy produces exactly catalysts like those requested by its domestic regulation. A State could take a snapshot picture of its production, and *ex post facto*, regulate in order to have its production level to equal its requested level.

In cases like this, it is extremely hard to discover the protectionist intent: obviously a demanding regulation, which is supposed to protect the environment will be well accepted by the public opinion, and the more demanding it will be, the wiser the regulator will look. It takes an extremely accurate cost/benefit analysis and a smart economist to blame a similar regulation, for being excessively demanding. Nevertheless, it is still possible to prove that a level of protection of the environment, or of public health, could be too high, and that the regulation setting is indeed detrimental for the value at stake.

Let’s take for instance mobile telephones, and let’s provide a very simple example. One State could duly ban them, because there is some proof that their use might allegedly provoke cancer. One State could allow their use without any restriction. What is the ideal situation? Even public health advocates could agree that it is better to allow them and to submit their use to a tax; with the amount of money collected through the imposition of that tax, States could finance the scientific research, and could consequently become aware of the actual risks they provoke, and of the possible solutions to avoid such risks. This is the result, taxing incomes finance scientific research; a regulation that is not absolutely and ultimately health-friendly in its immediate formulation could do better to public health interests than an apparently stricter one (the one banning mobiles).

We have seen how standards, despite their precision, could still be used to conceal protectionist intent, but this doesn’t need to be a major concern for us, because cohabiting with some form of “green protectionism”, in my views, is definitely a lesser evil.

In all, SPS and TBT agreements look better than the GATT, in the sense that they reduce, in principle, the potential to commit an error. As for the development of the case law and the sensitive position of the WTO judge in the interpretation of WTO law, we can adopt a very rough distinction to categorize the type of mistakes judges can make when dealing with borderline cases: sometimes they uphold an illegitimate measure (type A: ‘*I didn’t apply the [WTO] law where I should have applied it*’), and sometimes they sanction a legitimate measure (type B: ‘*I applied the [WTO] law where I should not have applied it*’).

If you want my opinion, I will tell you that I am not seriously concerned about type A mistakes, whilst type B mistakes are extremely serious, and should be avoided at all costs.



Why do I care about those errors much more? Because these are the errors that are linked to the institutional process much more intimately, and they undermine the very legitimation and the credibility of the WTO as an international organization. With a few bad reports, people lose faith in the free trade process: States sign an agreement to open up trade and suddenly they realize they are not free to choose their societal preferences. In principle, as I said, SPS is a better contract than the GATT, however I don't think it is sensible to overestimate the potential for reducing the problem. Essentially I think there are two reasons why this is the case: first, it is very difficult to move away from negative integration in the WTO, it is virtually impossible to think of harmonized policies in the WTO. TRIPS is an excellent example of how even minimum harmonized goals are impossible to achieve: some countries cannot abide to the bare minimum standard required by TRIPS. Can you imagine discussing public health standards? These are choices which would put a huge strain on most developing countries, if some protection levels were made compulsory.

**The judiciary of the WTO. The need for transparency.**

The other problem, the one that concerns me more, is the institutional design of adjudication in the WTO framework. The first instance, the Panel, consists of three people, essentially chosen by the Parties. Three people: this could mean three authoritative and well known scholars, or three young lawyers, or a mix of both, nothing is certain about the average composition of a Panel. If you go through every report issued by the DSB<sup>12</sup> you will discover that over 80% of people who were judges in the Panel are people who are first appointed in Geneva. If you enter the Italian Administration and they send you to Geneva, you are a secretary, you don't know anything about the WTO, but there is a very strong likelihood that you are requested to adjudicate a case about vehicles and catalytic converters. There is a material risk that non-trained people decide difficult or important cases.

Let us imagine, for instance, that a case is pending before a Panel, a case regarding some very technical issues (like those regulated by the SPS, by definition). Let us assume also that two experts are consulted to give their technical opinion about the issue at stake, and that their views irremediably diverge. How is the judge supposed to choose how to settle the dispute?

In the Hormones saga, for example, three scientific models have been successively provided about the health risk provoked by beef meat treated with hormones: science is evolutionary, luckily enough. Law stays the same for quite a few years, whereas science changes every day.

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<sup>12</sup> Dispute Settlement Body.

Let's imagine now an even worse scenario, in which there is a collusion among the scientists: they are ready to discuss an issue, but deliberately avoid tackling another issue. Again, the judge has no means to understand which of the parties of the trial deserves to win the dispute.

Another problem surfaces then, when it's time to choose experts to give a decisive opinion. Here in Italy it is the same, like anywhere else: when experts appointed by the parties disagree on one point, the judge has to appoint a neutral expert, and his choice will most probably follow a mere criterion of reputation. The same with WTO judges; furthermore, also the outcome of this procedure of consultation is similar: here in Italy when a neutral expert is appointed, the judge tends to follow his opinion, there are percentages showing that almost each time the judge is convinced by the view of the neutral expert. Again, the same occurs with WTO: every time a technical question arises (quite often, as we have explained) the judge virtually dismisses the case, and entrust its solution to a third expert.

At least here in Italy your judges conform to some accessory requirements, they go through a selection processes, they have tenure. Moreover, the Italian systems provide litigants with several instances to address when the decision of the lower instance is not satisfactory: one can always hope that his own case will eventually end up being decided by a wise and expert judge. In the WTO the case ends with those three people; and their (potentially) bad decision would be inflicted on the Appellate Body.

Furthermore, in a domestic legal order it is relatively easy to change a bad law, or to legislate to improve an old one, whilst in the WTO law-making is almost an utopia: 170 states should agree on a new law, this condition obviously makes this transaction extremely hard even to conceive. The agency costs when you have a domestic judge are minimal compared to the agency costs when you have an international judge.

The only aspect that seems to me promising is the current request for increased transparency: by increasing transparency, reputation costs increase as well.

Let's assume now that Pippo Fontanelli is a Nobel Prize physicist and that Italy asks him to write something about catalytic converters, to defend its legislation. He then confirms that Italian legislation is necessary to avoid acid rains. How can we be sure that a big Italian car industry has not paid Pippo Fontanelli a huge load of money to behave like he did? It could be possible that Pippo Fontanelli would be ready to say anything, if he gets paid very well, there is no way to know how things go in cases like that.

Now we can imagine two scenarios: in the first one Fontanelli speaks behind closed doors, so that only the judge listens to his speech; in the second one Fontanelli's expertise becomes public, circulates in the profession, and then to the rest of the world. In this second scenario, if Fontanelli's opinion is scientifically unreasonable, because it has been influenced by the lobbying forces, the scientific community will most certainly notice it, and a colleague will write a letter to the New York Times, and everybody will soon be aware that for one million euros Fontanelli told everyone that the moon is green, or the moon is orange: when considering the risk of suffering such a big reputation damage, he could think twice about behaving unprofessionally.

Why would he think twice? It is very intuitive, when you have a pool of people (the experts) a judge can choose from, it is easy that a professional behavior increases the possibility that the expert is chosen in another case: he has the incentive not to be a one-time player. Even people who like what you say, they will not hire you if they know that you lack credibility: transparency might put into question the possibility to act in a merely opportunistic way, again, it's not a perfect recipe, but it is something which helps detecting good faith and bad faith in scientific expertise.

In theory, what happens is that when a party loses a case before the WTO it has to implement the decision. Of course "implement" is a word deprived of meaning, if taken alone. In domestic orders, police takes charge of non-spontaneous implementation; in the international order, instead, such a role is played by counter-measures. If the State who lost the trial does not implement the decision, the winning State will be entitled to increase the level of duties against its exports.

As you can imagine, this is not an instrument that is equally effective in the hands of every State: if it is a Europe against Pakistan dispute, Pakistan will implement, because the European Union represents 80% of its export income. But if it is the other way around, Europe won't probably care much about Pakistan, because Pakistan's counter-measures would be virtually irrelevant for it.

Moreover, when a State imposes countermeasures against another State, it has to notify them every now and then to the DSB, but after six months the item disappears from the DSB agenda, so we might not know what's going on, we have to inquire. Again, if a State has not imposed countermeasures against the other State, the former might be negotiating

with the latter, but in this case as well after six months the item disappears from the agenda, and we cannot figure out what happened, so we have to inquire single cases on a one by one basis, and rely on unofficial documents and reports. If you look at the official documents only, we find that there is no case where a developed country prevailed, and a developing country did not implement. Usually developing countries immediately notify their implementation.

We even found nineteen cases where we have no information at all, that means that we don't know whether implementation occurred, or whether the winner State imposed countermeasures; they are all small country against big country cases. This is possible precisely because the small player thought that the countermeasures would become counter-productive. How can counter-measures be counter-productive for the State that imposes them? Counter-measures entail a cost.

If for example Italy raises its duties on mobile phones from 10 to 20%, Italian consumers would pay 20% more. Usually this initial sacrifice is tolerated because Italy expects that countries importing to Italy to lower their prices to keep competitive: in the long run the initial loss is more than back-paid.

But small countries cannot expect big exporters to adapt their policy to an irrelevant counter-measure, so there is no sense in imposing them, as they would amount to a cost only.

There are currently only a few cases in which counter-measures have been imposed and are still in place, and they are all cases between developed countries, all EC – US disputes, except for one Canada – US case:<sup>13</sup> it is somehow natural that actors bearing a similar bargaining power must resort to the ultimate available solution to settle a dispute, and that solution is counter-measures.

### **Final remarks.**

To conclude, we can reasonably say that in the WTO framework there is no plain guarantee for market access, differently from what happens, for instance, in the EC. Access depends on satisfaction of conditions that are unilaterally set by the import market, as we have said so far: no de-regulating momentum has so far occurred to erase regulatory diversity, and the sole guarantee that can be envisaged in the international trade system as of today is that, if at all, access will be granted at non-discriminatory conditions.

Market access (since tariffs have become largely ineffective) is negatively affected by the

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<sup>13</sup> Namely the *Hormones*, *Antidumping 1916 Act*, *Bananas* and *Foreign Sales Corporations* (FSC) cases. See P. C. Mavroidis, *Remedies in the WTO Legal System: Between a Rock and a Hard Place* (2000) 11 European Journal of International Law, 763 - 813

incompleteness of the GATT contract, and by the incentive for opportunistic behaviour. As long as agreements manage to reduce the scope for opportunistic behaviour (not an easy exercise, in the absence of an operational definition for protection), market access will benefit.

One should not exaggerate the potential for reduction though: non-discrimination (in light of the heterogeneity of players) is difficult to overcome, and the case-law has not helped, so far: discrimination should be defined in a different manner than it currently is in WTO law and by WTO judges.