

QUALIFIED MARKET ACCESS

**Final report
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THE EXECUTIVE SUMMARY

1. This study was carried out at the request of the European Parliament to examine the feasibility of 'Qualified Market Access' (QMA).

What is QMA?

2. The few available documents describe QMA only in general terms, as the possibility to 'qualify' imported food and agricultural products as meeting specific standards in terms of environmental protection and human welfare, and to increase import tariffs for non-compliant products.
3. Raising EU tariffs above bound rates would constitute a GATT law violation. Raising tariffs above effective rates would require the EU to compensate affected WTO members for the trade losses. Current EU agricultural tariffs leave little room between bound and effective rates. Giving tariff preferences to qualifying products or countries could also breach GATT MFN obligations, which can not be re-negotiated.
4. There is no consensus view on the standards that QMA should cover. Available documents refer to a variety of issues: human rights, social and labour standards, environmental standards, animal welfare issues, geographical indications, etc. Moreover, there is no indication whether this should be applied on a country or producer/product basis.
5. This study assumes that QMA applies to norms and standards regarding the quality of the production process, so-called non-product related Production Process Measures (PPMs), not the quality of the end product. End product quality standards already exist under TBT and SPS standards. Products that do not conform to these standards cannot be imported into the EU; there is no tariff differentiation.
6. Most of the international human rights, social, labour and environmental standards suggested in existing QMA documents are already covered by the EU's GSP+ scheme that offers tariff rebates as an incentive to apply these international standards, on a voluntary basis. A QMA scheme along these lines would not only duplicate GSP+ but also introduce an inconsistency by increasing tariffs for non-compliant countries, rather than reducing them for compliant countries, and by overriding the voluntary aspect of GSP+.
7. By elimination, this leaves only a narrow domain of regulation available for the potential application of a QMA scheme, namely PPMs in food and agricultural production, for example the Statutory Management Requirements (SMR), which aim to protect public, plant and animal health, the environment and the welfare of animals, and the Good Agricultural and Environmental Conditions (GAEC), standards where farmers are required to maintain soils, habitats and landscape

features, standards that EU farmers must comply with in order to be eligible for payments under the CAP. This report sticks to this interpretation of QMA.

8. Some QMA documents add the possibility to channel the additional tariff revenue to aid for rural development and the maintenance of local production resources in exporting countries. There are no indications on the extent of, or criteria for, a tariff increase, whether an increase would actually generate more revenue, nor on the allocation criteria for this aid. Such a parallel aid mechanism runs into many objections and entails risks of adverse incentive effects for producers. Aid for rural development may already be part of the EU's external assistance programmes if beneficiary countries have prioritised it in their development strategies.

The motivations for QMA

9. Two motivations can be distinguished. First, for EU producers: levelling the competitive playing field for trade in agricultural products, avoiding regulatory competition that is presumed to be unfair and could lead to a race to the bottom, social dumping, etc. Second, increasing EU consumer welfare by ensuring that consumers get the goods that conform with their preferences, even if they have been produced abroad.
10. QMA should start from the presumption that consumers feel aversion from consuming goods produced through social exploitation or in environmentally unsound ways. As long as this aversion is limited to own consumption, the problem can be largely solved through private voluntary labelling of (domestic and imported) food products. There is no need for mandatory standards in that case.
11. Two factors may justify the introduction of mandatory standards. First, consumer information problems may distort consumer choices. Second, to the extent that the aversion is also generated by consumption of sub-standard goods by fellow citizens, these externalities can only be addressed through mandatory standards. If these consumer preferences represent a truly 'collective preference', widely shared by most consumers rather than reflecting the norms of a limited group, mandatory standards can be justified.
12. Since the EU SMR/GAEC regulations – that this study takes as a reference point for QMA - have been adopted and made mandatory through due democratic process in the EU, they are assumed to represent collective preferences. The study is thereby confined to cases where no physical harm is done to EU citizens or environment but rather where outcomes occurring abroad are undesirable for EU consumers.
13. Extending EU collective preferences to producers outside the EU is more difficult to argue. While basic principles of human rights are almost universally accepted, social and labour norms, environmental standards, let alone animal welfare and other issues included in SMR/GAEC regulations, may be more controversial in non-EU societies

as perceptions are affected by cultural, social and economic differences. Because of uncertainties about the perceptions of citizens in exporting countries about these standards, any argument in favour of QMA should be motivated predominantly by the welfare effects for EU consumers, not those of non-EU producers.

The economics of QMA

14. If EU citizens only care about the impact of their own consumption on their welfare, than private voluntary labelling would be the easiest solution. However, if consumers care about the social and environmental externalities caused by production elsewhere in the world, then mandatory compliance with the rules in the EU is appropriate. This would be equivalent to cases where there is a strong and universally held aversion against a particular form of production (cf GATT Art XX). The key question is: do the regulatory domains covered by QMA cause such a strong aversion? For the proponents of QMA they do; for others they may not.
15. If the import of unfairly produced goods reduces consumer welfare in the EU for those who see *others* consuming these products, than a case can be made for restricting these imports. But if the primary concern is for social welfare and the environment in the exporting country, and we believe this is a development priority, than we must be willing to pay for it directly rather than by taxing imports from developing countries.
16. Given the uncertainties about the exact nature of the QMA scheme, we cannot rule out the possibility that we could find a version of it that would achieve a welfare improvement in circumstances. A tax on unethical imported products combined with a subsidy to producers overseas of an equivalent sum of money could improve the welfare of EU citizens if certain conditions are satisfied. But if these are conditions are not satisfied the results would be damaging. We do not however have enough information on costs, the actual incentive effects, and citizens' preferences to judge.
17. It is most unlikely that such a combination of tax and subsidy could ever be the best way to achieve the aims of the plan. It is extremely improbable that the optimal tax on undesirable imports would equal the optimal subsidy needed to promote sustainable/ethical production abroad. The logic of the scheme is that if our QMA tariffs caused all exports of undesirable imports to cease, there would be no money to contribute to the Rural Development Fund and to change in production methods in developing country trading partners.
18. While the number of empirical studies available on this subject is limited, they indicate that there is only a very modest loss of competitiveness for EU farmers due compliance costs with the new SMP and GAEC rules, which would not seem to justify tearing up the WTO rule book. In the absence of estimates of compliance costs with SMR/GAEC regulations in developing countries (since there are not

required there), compliance costs with EU supermarkets rules (Eurepgap/Globalgap) were used as a proxy. These appear to be quite burdensome, especially for small farmers in developing countries. Farmers can profit from price premia for higher quality products but empirical evidence highlights that this is more likely for richer developing countries and commercial farmers. Studies of price premia for 'fair trade' products yield little useful evidence, mainly because of the difficulty of extrapolating the preferences of EU consumers as a whole from the fraction of products that go through fair trade channels.

19. Some QMA documents refer to a financial mechanism that would use the additional revenue from additional import tariffs to finance a rural development fund, to help farmers in exporting countries to comply with EU standards. Since tariff increases beyond bound levels are not admissible under WTO, room for increases is very limited under current EU tariffs since effective tariffs are close to bound tariffs in most cases. Differentiation would mostly have to be in the form of tariff rebates for compliant goods. That practically precludes the use of additional tariff revenue for a fund that finances rural development operations in developing countries. Even if there were room to raise revenue, the objective of setting up a fund would be self-defeating: the success of the QMA policy measures in terms of consumer and producer welfare in the EU would be inversely proportional to the amount of additional tariff revenue raised. Moreover, there is no explanation in QMA documents of how it is to be allocated. Assuming that a bonus is given to producers who do meet the PPM conditions, equity among producers in developing countries may become a major issue.

The legal issues

20. Raising the tariff duty for a non-qualifying product risks triggering a GATT law violation and require the EC to compensate affected WTO Members. GATT Article II requires that WTO Members charge their tariff duties not in excess of their bound tariff schedules, which can be modified based on compensation or retaliation. If an increase is made on a non-qualifying product above the applied rate, but which is still below the EC's scheduled binding, a breach of the obligation of most-favoured-nation (MFN) treatment can occur if the products are 'like' products and the non-qualifying product is predominantly produced in certain countries.
21. If restrictive tax or regulatory measures are applied to both domestic and imported non-qualifying products, then GATT (Article III) national treatment rules require that imported products are treated no less favourably than like domestic products. Regulatory and tax distinctions made on the basis of PPMs are less favourable treatment of imports if the PPM and the non-PPM product are in a direct competitive relationship and the distinction results in the 'group' of imported products (both PPM and non PPM) to be treated less favourably than the 'group' of like domestic products.

22. A GATT (Article XX) general exception may be invoked for a violating measure, e.g. for the protection of public morals, human health or for conservation of natural resources. An offending measure must be necessary to achieve the objective and there must be no reasonably available alternative that is less restrictive. Diplomatic activities or product labelling may be raised as less restrictive alternatives but they will probably not be found to be equally effective. The possibility of excusing a violating measure under a GATT general exception is enhanced where the objective and the level of protection being set can be validated by reference to other public international law.
23. QMA product measures may be supported by product certifications or labels, or may substitute for QMA trade measures. As applied to agriculture products, the legality of certificates and labels should be assessed according to the GATT and the WTO Agreement on Technical Barriers to Trade (TBT) rather than the Agreement on Sanitary and Phytosanitary measures (SPS). The opinion here is that product labels designating PPMs do fall under the TBT Agreement and are subject to those disciplines, including the requirement to use international standards when they exist, and the obligation that a label may not pose as an unnecessary obstacle to international trade. The TBT Agreement also opens the possibility of initiating or supporting an international standard body open to the standard bodies of all WTO Members for the composition of QMA standards, certifications and labels.
24. QMA trade measures may result in possible incoherence with existing EC preferential systems (GSP plus) if QMA utilizes different international criteria for treatment. A qualified GSP recipient could be receiving trade preferences at the same time its producers are subject to QMA trade restrictions for failing to meet other standards.
25. Any QMA trade measure considered should be made on the basis of producer and product certification and not on the basis of country of origin. Any discrimination analysis of this measure should occur based on the overall impact on imports and like domestic products. Any QMA measure should draw as strongly as possible on existing international organizations and broadly adopted international legal regimes.

Conclusions

26. The concept and mechanism of QMA, as described in existing documents, remains vague. In order to arrive at a workable definition of QMA, in conformity with existing WTO legislation, it needs to be narrowed down to compliance with EU domestic production process standards for imported food and agricultural products, for example environmental, animal welfare and health standards under the EU's Statutory Management Requirements (SMRs) and Good Agricultural and Environmental Conditions (GAEC). Where these standards affect the physical characteristics of the product, they should be declared under the TBT Agreement.

27. Applying QMA through technical regulations falling under the TBT Agreement would exclude tariff increases and thereby render the proposed financial mechanism void. Non-compliant products cannot be imported into the EU, or not with(out) a particular label; paying a higher tariff does not change that.
28. Extending QMA to cover international environmental, human rights, social and labour agreements would duplicate the existing GSP+ scheme. It would also entail a country-level, rather than a product level, application which would discriminate against compliant producers and products. Verification of compliance with GSP+ conventions at product level would be burdensome.
29. PPM standards are controversial in a WTO context but there is no explicit opinion against them. Provided the proposed PPMs do not discriminate between domestic and foreign producers, they may also be compatible with Article 2.2 of the TBT Agreement, where applicable (namely where the PPMs affect the physical characteristics of the product).
30. The economic benefit for EU consumers depends on whether these PPMs reflect a true collective preference; if not, labelling of goods would be preferable over mandatory regulation. If they are only introduced to avoid regulatory competition for producers, without matching consumer benefits, then they could be welfare-decreasing for the EU. The economic benefit for producers outside the EU depends on many variables and is hard to predict; there is insufficient empirical evidence to draw a general conclusion.

Chapter 1. The Conceptual Background and Economic Analysis

1.1 Background

In its budgetary comments in 2007 the European Parliament requested a feasibility study on ‘*Qualified Market Access (QMA) or - the possibility of ‘qualifying’ imported products to ensure that they meet specific standards in terms of environmental protection and human rights.*’¹

This request was repeated in a letter to DG Trade by Graefe zu Baringdorf MEP, on behalf of the Agricultural Committee. The letter refers to a study on the possibilities to apply a QMA scheme of environmental and human rights standards to trade in food and agricultural products. It also includes proposals for specific measures to that effect in the context of the WTO negotiations.² The request was not unsurprising for the debate on the issue of QMA in the EP goes back several years, surfacing in several Parliamentary resolutions³ and committee reports.⁴ Outside the EP, QMA-related issues have been debated by various NGO's and the discussion is closely linked to trade policy issues such as fair trade, the prevention of social and environmental dumping, and regulatory competition.

At the heart of the QMA debate is the fact that differences in norms and standards between countries create differences in production costs and thereby affect the level playing field for competition in international trade markets. Proponents of QMA measures argue that the playing field needs to be levelled again, this time through differentiation in market access that corrects for differences in costs caused by different regulatory burdens. Indeed, the issue of protectionism is never far away in the QMA debate. Some QMA proponents are quite open about this and refer for instance to the need to protect the agricultural sector and a country's self-sufficiency in food; others are more nuanced. Opponents argue that countries are free to define their own standards; differences in regulation reflect differences in preferences and social, economic and political realities. Nevertheless, one country's decisions may have economic and non-economic spill-over effects on other countries. It is because of these potentially negative externalities that there are limits on how far countries can go. Restrictions are reflected in various international agreements on human rights, environmental and labour standards, basic trade rules, etc.

QMA proponents argue that at present, international agreements are not enough to limit any negative spill-over due to regulatory competition in international trade. While some basic human rights principles are by now universally accepted, norms regarding the environment and social welfare, let alone animal welfare, remain more controversial.

¹ GzB letter. Annex 1.

² *Ibid.*

³ *Ibid.*

⁴ See for example: the report on a strategy for biomass and biofuels, from the Committee on Industry, Research and Energy. A6-0347/2006. Para 46; the report of the promotion of crops for non-food purposes, from the Committee on Agriculture and Rural Development. A6-0040/2006. Para 62.

Thus, the debate about which regulatory competition between countries should be permitted or restricted boils down perceptions on the social, economic and political acceptability of the proposed norms and values. While some may reflect a real ‘collective preferences’⁵ adopted through due political processes in a particular jurisdiction, they may still be subject to debate in other countries or socio-economic groups, or even conflict with existing international agreements.

The present report directly responds to the Parliamentary request addressed to DG Trade. It examines the feasibility and potential implications of using tariff differentiations to limit regulatory competition through social and environmental norms in the case of trade in food products. It is a technical report and therefore does not attempt to identify the right balance in regulatory competition in food and agricultural production. Clearly, identifying that balance is a political process. Rather, this report aims to describe the contours of the decision making process, the legal, economic and administrative issues involved, the pros and cons of various arguments and approaches. The report examines and clarifies the concept of Qualified Market Access for trade in food and agricultural products. It assesses its relationship to adjacent concepts such as Production Process Measures (PPM) and trade policy instruments such as GSP+, SPS and TBT. The analysis includes an economic assessment of the costs to the EU of competition from ‘low standard’ trading partners; the cost implications for developing country exporters of being asked to comply with EU norms, and it provides empirical evidence where available. It reviews the evidence regarding the benefits to the EU consumers of higher standards, particularly as reflected in their willingness to pay extra for them. A legal examination is also included, which covers the conformity of QMA schemes with GATT/WTO obligations and the potential systemic implications of alternative ways to achieve these ends.

The report does not seek to cover a wider range of issues related to non-food products such as environmental goods or energy and carbon footprint issues where trade-related PPMs may also play an important role. The environmental dimension is interpreted within this report to refer to local environmental issues in producer countries. Global environmental issues such as carbon footprints and climate change aspects are not addressed unless explicitly mentioned.

⁵‘Collective preferences and global governance: what future for the multilateral trading system.’ Speech by EU Trade Commissioner Pascal Lamy.

http://trade.ec.europa.eu/doclib/docs/2004/september/tradoc_118929.pdf. See also commentary, Steve Charnovitz ‘An Analysis of Pascal Lamy's Proposal on collective preferences’ *Journal of International Economic Law* 2005 8(2):449-472; doi:10.1093/jielaw/jgi029

1.2 What is QMA?

The concept of QMA is not clearly defined. There is no official or widely recognized definition and there are few documents and studies that attempt to define it. In generic terms it could be described as an attempt to protect markets with high environmental and social standards, such as the EU market, against unfair competition from exports from countries that have lower standards. In other words, QMA measures seek to protect markets from social and environmental ‘dumping.’ This is made clear in a key QMA paper by the Ecofair group of NGO's:⁶

Including social and environmental requirements in trade rules is essential because multinational trade corporations and food retailers, which dominate world food markets, are increasingly shifting their investments in food production to countries where environmental and social requirements are lowest.

In order to avoid further ecological and social dumping, and to support more sustainable food production practices, tariffs should not be simply cut or reduced. Instead, market access must be qualified. In order to reduce unsustainable practices, social, and ecological standards should be applied on imports and exports so that they can work like trade filters.

Thus the assumption that competition in food and agricultural production can take place in a liberalized global market without policy space for local, regional and national governments is erroneous. (..) Trade rules must include incentive and levies which strengthen local food production instead of destabilizing it.

Multilateral rules on trade in agriculture and food should therefore clearly distinguish between trade rules and policies for those farms and enterprises operating on a local or regional scale, and those operating on a global scale.

It is therefore important to widen policy space and explore diversified standards and instruments which could define market access conditions. They must reflect the extreme disparities regarding the size of farms and enterprises as well as geographical, climatic and technical conditions of local production.

The paper goes on to recommend:

This paper wishes to encourage governments and the international community to include Qualified Market Access and trade preferences into the multilateral and bilateral trade negotiations in order to balance economic with social and environmental objectives.

⁶ Lorenzen, H. ‘Qualified Market Access How to include environmental and social conditions in trade agreements’ Discussion Paper No. 5 / March 2007 / English Version. p 5.

Developing countries and developed countries alike are encouraged to define criteria and standards for food imports which would ensure that national food security and rural livelihoods are not undermined.

Countries which have achieved a higher level of social and environmental legislation and standards should effectively safeguard these standards in their territory. Based on these inclusive achievements, they may claim the right to apply levies on imports which could undermine these existing standards.⁷

The above passages advocate a trade policy stance that seeks further regulatory segmentation in world food markets and protection through tariff differentiation and market access conditions. Much of that goes against prevailing EU and indeed globally accepted trade policies, and against basic WTO trade rules – as will be argued in the legal section of this report.

Although the general concept and underlying trade policy stance of QMA proponents is clear, it is not at all clear which specific regulatory domains could be subject to QMA. For example, although the Ecofair paper is subtitled ‘How to include *environmental and social* conditions in trade agreements,’ it does not provide a comprehensive list of the environmental and social standards to which QMA could be applied. Furthermore, it offers only two examples of QMA standards, *organic food and geographical indications*, in which participation is voluntary. These two domains are already governed by public EU standards. Price differentiation is not achieved through tariff differentiation but through the market and the significant price premia that organic foods fetch on markets. Regarding GI's, the EU has already submitted proposals to strengthen worldwide recognition of GI's under the current Doha Round trade negotiations. Though there is opposition from some partner countries, the EU has made this a key issue in the negotiations and is hopeful that progress will be made in this domain. Again however, there is no need for any tariff differentiation to achieve wider GI recognition. Products that violate established GI's in the EU are simply not allowed into the market. While organic food standards could be interpreted somehow as environmental standards in a number of cases, GI's are certainly not environmental standards. These two examples are not very relevant to the QMA debate.

Most bilateral trade agreements include a human rights clause that provides for the possibility to suspend the agreement and associated tariff concessions in cases of gross human rights violations. This could be interpreted as some crude form of QMA. However, the letter from Graefe zu Baringdorf MEP requested research into a different approach, setting *environmental and human rights* standards as the defining criteria. What the QMA proposal seems to suggest is not the suspension of preferences in cases of violation, but to impose a higher price for such violations, over and above MFN tariffs. Such standards-based market access conditionality is not entirely new either. For example, developing countries can already receive additional tariff reductions or exemptions, over and above those under the EU's unilateral GSP scheme, if they sign up to and effectively implement 27 basic human rights, labour rights and environmental conventions – the so-called GSP+

⁷ *Ibid.* p9.

scheme. This is clearly a form of QMA – differentiated market access – at country level. Most developing countries have access to this scheme. The GSP+ list of environmental and human rights conventions covers all important international conventions⁸ in this domain and, as such, would satisfy Graefe zu Baringdorf's proposal if considered from a country level perspective. International agreements on environmental and human rights issues can only be applied at country level. Significantly, the GSP+ system lowers tariffs preferentially below MFN rates; it does not seek to raise them through punitive tariff rates.

Further, the reference to international agreements implies that some proponents of QMA have country level, rather than product/producer level, tariff differentiation in mind. In principle, national authorities that are signatories to these international agreements are responsible for their application in their territory. The Commission monitors effective implementation of the 27 conventions under GSP+, mostly by reference to work undertaken by the relevant international monitoring bodies. For instance, "serious and systematic violation" could be recognised if the competent monitoring body had already reached that conclusion. Cases of ineffective or partial implementation would be more difficult to settle, especially if it would concern only a few producers. This would make it difficult for the EU to apply these GSP+ standards at individual product or producer level.

However, none of the QMA documents consulted gives any explicit indication as to whether the scheme should be applied at the level of countries, products or producers. The GSP+ standards are nation-wide and not conditions of production for specific goods at the level of individual producers. The respect of ILO labour conventions, sometimes included in trade agreements, falls in the same category of nation-wide conditions. Since these existing schemes do not seem to satisfy the proponents of QMA, it must be assumed that these international agreements are not what they are referring to.

The EU Action Plan on Forest Law Enforcement Governance and Trade (FLEGT) comes closer to the concept of QMA. At the core of FLEGT are Voluntary Partnership Agreements with timber-producing countries that wish to eliminate illegal timber from their trade with the EU. These agreements will involve establishing a licensing scheme to ensure that only legal timber from producing countries is allowed into the EU. Unlicensed consignments from Partner countries would be denied access to the EU market. The agreements are voluntary, which means that Partner Countries can decide whether or not to sign up, although once they do so the licensing scheme is obligatory. Currently there is no law to prevent illegally-logged wood products from being imported into the EU. A new EU regulation is therefore required to empower Member States' customs authorities to enforce this scheme. The Action Plan foresees the possibility of EU development assistance to help establish licensing schemes, where needed. However, it differs from QMA in the sense that there will be no additional import charges.

QMA also differs from conventional quality standards on imported products, such as SPS measures, which affect the phytosanitary safety of products, or technical TBT standards that affect the characteristics of the product. These are end-product quality standards.

⁸ Most of these GSP+ agreements are not universally accepted but widely accepted; many countries though not all have signed up to these human rights, labour standards and environmental agreements.

Products that do not conform to these standards cannot be imported at all into the EU; therefore increasing tariffs on these products makes no sense. Rather than the quality of the end product, QMA is concerned instead with the production methods that have been used to produce the goods, the effects of which are not necessarily traceable in the characteristics of the end product. In technical jargon this is called non-product related production process methods (NPR PPMs). The standards involved do not directly affect the material well being of the consumers in the importing country. They may however have indirect welfare effects on consumers. For instance, production methods may affect global public goods like the quality of the environment. They may also have immaterial welfare effects on consumers in importing countries. And they may have a direct impact on the welfare of persons involved in the production process in the exporting country (immediate social and environmental effects including the impact on animal welfare). As such, QMA standards are often alleged to seek to ‘export’ domestic consumer preferences by encouraging the transfer of EU production standards to the exporting country.

In the absence of clear indications in the available QMA documents, this study has identified a logically coherent interpretation of the norms and standards that might be applied in a QMA-like tariff differentiation mechanism. Since the request for this study came from the Agricultural Committee in the EP, it is assumed that QMA is meant to cover imports of food and agricultural products; the analysis does not cover industrial products or services. Furthermore, tariff differentiation is interpreted in a wide sense, covering both increases and decreases. After elimination of end product standards like SPS and TBT, as well as country level standards such as human rights, labour and environmental conventions covered by GSP+, only a narrow domain of regulation remains for the potential application of a QMA scheme, namely Non-Product Related Production Process Measures (NPR PPMs) in food and agricultural production. Examples of NPR PPMs in EU agriculture include the Statutory Management Requirements (SMR), which aim to protect public, plant and animal health, the environment and the welfare of animals, and the Good Agricultural and Environmental Conditions (GAEC), standards where farmers are required to maintain soils, habitats and landscape features.⁹ GAEC rules are standards that EU farmers must comply with in order to be eligible for payments under the CAP. They are set by member states and are additional to the EU directives. As a result, farmers incur compliance costs that presumably affect their competitiveness on global markets. This report holds with this interpretation of QMA.

The issue of PPMs has been controversial in international trade policy debates. In the GATT era it was considered illegitimate for countries to use import restrictions to seek to distinguish between ‘like products’ produced in different ways, for example tuna fish caught in nets that did or did not endanger dolphins.¹⁰ The creation of the WTO led to a reappraisal of this debate. The famous ‘shrimp turtle’ case re-opened the possibility that countries (in this case the US) could ban the import of otherwise indistinguishable shrimps on the grounds that they had been caught in nets that endangered turtles¹¹. The WTO Appellate Body ruling did not state that PPM import restrictions were generally legal but it

⁹ http://ec.europa.eu/agriculture/eval/reports/cross_compliance/full_text_en.pdf.

¹⁰ *US – Restrictions on Imports of Tuna*. DS21/R 1991 (not adopted).

¹¹ *US – Import Prohibition of Shrimp and Shrimp Products*. WT/DS58/R/AB 1998.

opened the possibility that such measures might be defensible in some cases. Some would argue that such measures are indispensable at least to set a floor level of minimal acceptable conditions for traded goods in an age where environmental and social concerns are an increasingly reaching beyond national borders and are reflected in ‘collective preferences.’ This report examines the complex legal issues surrounding the use of PPM-based measures in international trade.

1.3 Why QMA?

There are at least two possible interpretations that motivate the proponents of QMA:

1. To seek to protect the level playing field for trade in agricultural products in the interests of EU food producers and avoid regulatory competition presumed to be unfair, potentially leading to a race to the bottom, social dumping, etc.
2. QMA would increase EU consumer welfare by ensuring that consumers get the goods that meet their preferences, even if they have been produced abroad. There is a presumption that consumers would feel disutility from consuming goods produced through social exploitation or in environmentally unsound ways.

We discuss both motivations in more detail, in reverse order.

Consumer preferences

People may object to buying products made for instance by child labour or in environmentally harmful ways. In the case of collective preferences they may object to such goods being sold at all in the EU, even if they do not buy them themselves.

There is an extensive theoretical literature concerning the logic of citizens of one country expressing preferences and taking action to enforce those concerning purely domestic policies of trading partners. Howse and Regan (2000) have argued that US consumers may well experience disutility if animals are harmed in other countries. This is particularly likely if this is the consequence of individuals’ own consumption of an item produced in an ‘unfair’ manner. But there can also be concern if, for example, fellow citizens wear fur coats associated with cruel trapping. It is possible to feel disutility if people, animals or the environment are maltreated elsewhere, even if this is not the result of our own actions; and we may feel a desire to take action to prevent this, using the one relevant instrument at our disposal - trade policy. This is however somewhat different from a wish to encourage others to behave differently but feel that our main legitimate concern is to prevent competition via a ‘race to the bottom’ leading to a deterioration in conditions at home.¹²

¹² Gatsios, C and Holmes P (1998) ‘Regulatory Competition’ New Palgrave Dictionary of Economics and the Law.

If consumers in the EU are only concerned with their own consumption, then the problem can be addressed through private voluntary labelling. It becomes more complex if consumers are concerned also with others' actions. Government declared and enforced regulation can be assumed to reflect 'our' collective preferences, but private voluntary labelling may reflect only the preferences of subgroups. For goods produced inside the EU we do often impose mandatory standards on all production, which implies the assumption that this is a 'collective' preference. Where the good is produced both abroad and in the EU, there is of course an additional concern. If we impose high standards within the EU we may be concerned if high standard production here is replaced by lower standard production abroad. This is not universally a bad thing, if for example the foreign exporting nation rationally has different collective preferences from our own, for example in having a freely chosen lower labour standards. It is possible however, that foreign standards are very different from those of the EU and considered to be unacceptably so by EU consumers and voters, in which case questions arise as to whether the goods should freely be sold in the EU. Free traders have however traditionally argued that it is the business of sovereign exporting states to decide their own standards.¹³

The impact on the welfare of EU consumers depends on the strength of their preferences. EU consumers who desire the QMA compliant products will presumably gain both from utility regarding their own consumption and from the reduced consumption by others of non-compliant products. Consumers who do not have these preferences will lose because they will pay a higher price for a product whose qualities don't matter to them. The net overall balance of gains and losses to consumers is a matter of the extent of collective preferences.

Producer interests

The advocates of QMA are concerned about what is termed 'unfair competition' where it is argued that the foreign producer is able to charge lower prices in the export market only because they do not pay the true social or environmental cost of their production. Fears have been expressed that regulatory competition in this context can lead to a competitive lowering of standards, a 'race to the bottom' or 'social dumping' or, in more neutral economic jargon, regulatory competition.¹⁴ Advocates of QMA seek to deter such imports into the EU on the grounds that imports may lead to competitive pressure to lower EU standards. Advocates of trade liberalisation on the other hand claim that this is an opportunistic excuse invoked by protectionists.

Without tangible consumer preferences for QMA standards on imported products, such a scheme would clearly be a protectionist measure only of benefit to producers, driving up consumer prices without any welfare benefit in return. Most QMA documents emphasize

¹³ See Bhagwati, J and Hudec, R. Fair Trade and Harmonisation. (1996).

¹⁴ Alan Deardorff's glossary defines 'social dumping' as: 'Export of a good from a country with weak or poorly enforced labour standards, reflecting the idea that the exporter has costs that are artificially lower than its competitors in higher-standards countries, constituting an unfair advantage in international trade.' <http://www-personal.umich.edu/~alandear/glossary/s.html>.

this ‘unfair competition’ aspect and therefore give the impression that protectionist motivations dominate the debate. However, to the extent that consumers do indeed prefer the application of these standards to imported products, it cannot be a purely protectionist policy. The ultimate gauge of the welfare impact of QMA thus hinges on consumer preferences. The conditions under which QMA measures might be economically beneficial are further analysed in the next section.

Given the mix of motives,¹⁵ a variety of measures or instruments could be used to address the issue of what are deemed unacceptably low standards abroad. They range from soft private voluntary labelling schemes; compulsory labelling of production process conditions; the imposition of taxes or higher tariffs on non-compliant imports; and, in its strongest form, bans on the import of products that do not comply with our internal rules. The welfare impact of possible QMA measures will also depend on the choice of instruments. In many cases, existing practices regarding voluntary labelling may well be sufficient, especially when consumers are mostly concerned about their own consumption. If they are also concerned about others' consumption, than mandatory regulation may be required, but that raises the ethical issue of imposing preferences on others. If preferences are truly collective and all consumers share them, there would be no need for mandatory regulation since all consumers prefer and would buy the labelled goods that correspond to their preferences. Only if consumers experience tangible negative effects from others' consumption of non-QMA-compliant goods would there be a case of mandatory regulation.

This is the case for instance for outright bans in cases where the lower standard of production creates health and safety risks for EU consumers. But a ban has been called for against Canadian seal fur for instance, where there are clearly no safety risks to EU consumers but strong ‘psychic’ negative externalities. The extent to which the ‘disutility’ from safety risks can be equated with the ‘psychic disutility’ from consumer aversion for particular production methods, even if only consumed by others, is more a matter for ethic than for economic debate. Since standards of morality and ethics differ across the globe, there is no consensus on this.

¹⁵ In a direct communication Lorenzen suggests:

‘QMA should do both: prevent dumping and transfer social and environmental standards in third countries. This does not mean that the countries from which we import goods have to take over the EU legislation (we would not prevent them from developing even better or more adapted rules). But those enterprises producing for the EU have at least to fulfil basic EU and ILO standards in order to get free access to the EU market or they would have to pay the import-levy. This will have a positive impact on the political process of setting standards in the country concerned.’

1.4 The economics of QMA

Having identified a workable definition of QMA revolving around tariff increases on food products that do not comply with EU production process measures (PPMs),¹⁶ it is possible to analyse the potential economic implications of such a QMA scheme. To identify the costs and benefits of intervening in markets to achieve a particular PPM standard, the instruments to be used to apply the QMA policy must be defined. As explained above, the proponents of QMA propose to use tariffs as an instrument to regulate market access. However, there may be other options too, including private voluntary labelling.

Private labelling would be sufficient to solve the problems that QMA purports to address, as long as advocates cared only that they themselves observe the standard they propound. If they wish to impose it on everyone else in Europe, the issue becomes one of trading off their benefits from seeing it applied against the costs borne by other people who do not care about it. This in turn depends on what proportion of the population care about the standard and the extent to which society as a whole judges it to be important enough to impose costs on some of its members.

This section examines the direct costs and benefits of QMA standards only. It does not look at indirect effects, which would require general equilibrium modelling. It does not examine long-run strategic considerations, such as possible retaliation by trading partners or the consequences for the viability of WTO rules. Neither does it go into an analysis of the underlying moral imperatives that drive advocates of QMA.¹⁷

This section suggests that trade restrictions will rarely if ever be the most efficient policy measure – i.e. there are others options available at lower cost - for achieving standards on European consumption. However, if one places a sufficiently large value on achieving the standard, and a large enough proportion of the population wishes to do so, then one ignores the strategic possibilities that others retaliate against European exports, it could be argued that imposing trade restrictions is better than doing nothing.

1.4.1 Labelling

We start with the possible simplest case. If we suppose that some consumers wish their own consumption satisfies the standard and that they are willing to pay (some of) the cost of its doing so. The utility of the standard is private to those consumers and will be pursued willingly if the cost is less than the utility on the margin paid. In this case the obvious solution is labelling, for it enables producers to demonstrate to consumers that they have met the standard and claim a premium on the price for doing so. Profit maximisation will

¹⁶ For example, those contained in the SMP and GAEC cross-compliance requirements.

¹⁷ Indeed a further extension is to note that if the standard upholds some moral imperative, why do advocates of QMA stop at imposing the standard on European production and consumption? Why not try to impose it upon production and consumption in the whole world? But in that case we have to recognise that the rest of the world may have imperatives that it wishes to impose on us and the risk to the institutions of global cooperation may become fatal.

drive them to do so. There will emerge two versions of the product – the non-PPM one as before and a PPM one - and assuming constant costs and competition in both markets, the latter will command a premium r equal to the cost of meeting the standard. Producers are indifferent about which they produce – both generate normal profits – but consumers potentially reap additional surplus. The non-PPM consumers are unaffected, whereas those who care about the standard will be indifferent if they value it at just r but gain utility if their valuation is higher. Some of these may place such a high value on meeting the standard that they were previously not consuming at all, or at least consume more once they know that production meets the standard. The absence of any labelling results in undistinguishable versions of a product. Consumers expect, and hence producers deliver, the non-PPM version of the product. That is, in the absence of the labelling, no-one would be willing to incur the cost of meeting the standard because they would not be able to claim any reward for doing so. Everyone pays the same price, but some consumers suffer dis-utility because they suspect or know that their consumption is violating their principles.

If costs of production and of achieving the standard are not constant, the analysis becomes more complex. It is likely that the diversion of demand reduces demand for the non-PPM good and so drives down its price. Producers who for some reason cannot meet the standard within the premium paid for PPM-goods will lose, but their consumers will gain. Conversely, if the standard does not cost anything to achieve, but still commands a significant premium from consumers, it is possible that as the price of the PPM-good increases sufficient consumers switch to the non-PPM version that its price increases too. The result is that output of the non-PPM good actually increases.¹⁸ Producers gain and consumers lose.

In order to pursue a labelling solution, the labelling has to be credible: there has to be a way in which firms are induced to label honestly. If they do not, the labels are devalued and in the limit the market collapses back to the single non-PPM good. The threat of litigation and a free press may be able to achieve this. Alternatively the industry may be able to set up a certification process with sufficient independence to ensure firms' honesty. The next step is to make the certification official: firms are not obliged to label that they do or do not adhere to the standard, but if they claim to do so, this fact must be verified by the government or a government accredited agency. Provided that the costs of certification are covered by the industry (and indirectly their customers, of course) this seems an efficient use of the government's reputational capital, provided of course that they are capable of certifying honestly. If some of the costs are publicly funded, it becomes a subsidy to the standard and would need to be justified by some sort of public interest argument. We turn to this case below.

A further extension of this line of thought is to compulsory labelling, whereby the government insists that all varieties of the good be labelled as either satisfying or not satisfying the standard. This is not quite the same as food labelling, where calorific values and nutrient values have to be displayed. In the latter case labelling refers to a continuous variable, so that 'no label' could not be equated with either no calories or infinite calories. In the case of an on-off standard 'no label' might reasonably be thought of as indicating no

¹⁸ Mattoo, A. and Singh, HV. Eco-labelling: policy considerations . *Kyklos*, 1994. 47 (1), pp53-65.

standard. Governments might not be convinced that in the absence of a label consumers are clear what standard actually applies which might justify a compulsory label. Also the presence of an 'off-standard' label might be a way of encouraging consumption of 'on-standard' products where the premium consumers are willing to pay does not cover the cost of implementation of the standard or simply signalling government approval of a voluntary standard.

Finally, labelling can turn into a barrier to entry – an anti-competitive practice – if the certification process is not cheaply and rapidly available to firms that can achieve the standard. For example, the licensing of medical practitioners is frequently controlled by the medical profession itself, with the result that it can control the number of doctors below competitive levels.¹⁹ It is plain in this case that, if the labelling is effective, it achieves all that we desire. Those who value the standard can observe it, while those who do not, don't.

1.4.2 The limits to labelling

Labelling could be a solution to the policy issue raised by QMA proponents, as long as individual consumers care and are affected only by the costs and benefits of their own consumption choices. As soon as one person's choice creates spill-over effects for other persons, and especially when these are negative and costly externalities for the persons affected, than the issue become more complicated. Labelling would not be sufficient anymore to ensure that all individuals make consumer choices that have no externalities on others. Mandatory regulation of market access would become the only solution in that case.

So the key question is: are there any potential sources of spill-over's or externalities related to the domains of regulation that have been linked to QMA? Recall that we narrowed down a workable definition of QMA domains to environmental and animal welfare subjects covered for example under the EU's Statutory Management Requirements (SMR), which aim to protect plant and animal health, the environment and the welfare of animals, and the Good Agricultural and Environmental Conditions (GAEC) that focus on soils, habitats and landscape features. While there are unlikely to be direct physical spill-over effects in these domains from farmers producing outside the EU to consumers in the EU, non-respect of standards may generate indirect and psychic discomfort for EU consumers.

Physical and psychic externalities

Advocates of the QMA wish to ensure that not only does their consumption adhere to the standard, but that everyone else's does as well. They claim that anyone's consumption of non-PPM goods causes them disutility – there is an externality - and that this should be addressed in the name of economic efficiency. The externality could be objective e.g. water pollution, or psychic, it just makes them feel bad – but if it is genuine *and accepted*

¹⁹ Broscheid, A and Teske P.E. Public Choice, Vol. 114, Numbers 3-4, March 2003, pp. 445-459(15).

by *society as such*, it warrants intervention in the form of a mandatory standard.²⁰ Often advocates aim not at reforming worldwide consumption, but only that of their compatriots – in our case, other Europeans. Others may see no compelling moral reason to restrict interest just to European consumption, but maybe ‘real politik’ leads European advocates to feel that success is more likely in Europe, and that therefore that this is the place for them to start. Consistency would suggest, however, that changing consumption the world over is the ultimate goal.

Externalities related to information problems

Information asymmetries result from high transaction costs for consumers to obtain relevant information on product characteristics or production methods that influence the environmental performance. For example, too much and complex labelling takes too much time to analyze and consumers may ignore the labels. In these circumstances, neither voluntary nor compulsory labelling works and thus the information asymmetry has to be overcome by a mandatory standard. Similarly, bounded rationality can explain why even well informed consumers do not act according to their preferences when making purchase decisions. Finally, principal agent problems occur where the incentives of purchasers and consumers are not aligned. This might apply, say, to supermarket chains that pre-select a limited range of products on behalf of the consumer, but in most consumption it is not a major issue.²¹

The case would have to be made that there are indeed externalities in the regulatory domains associated with QMA – it is not self-evident. However, since mandatory PPM standards already exist and are implemented in the EU home market to reduce and/or remove perceived externalities, we will assume that such externalities effectively exist. This is a crucial assumption in the remainder of the economic analysis that follows. Note that this boils down to a *de facto* further narrowing of the definition of QMA, to regulatory PPM domains where externalities effectively exist.

We will examine first the case of an externality in production and the impact of various policy responses to that involving both domestic and foreign producers. We will explore the issues under a number of assumptions about preferences of home consumers of the good to the removal of the externality at home and abroad. Individuals may differ in their valuation of an ‘environmental bad’ - say air pollution - or feel greater or less disgust about say the treatment of animals in food production. Some consumers may care about the presence of the externality abroad even if it has no physical implications for them, for instance, local water or air quality. We will therefore explore the issues in four different cases:

- where preferences in Europe about the externality and hence the resulting standards are universally held, i.e. where there are no dissenters

²⁰ Mandatory standard are standards backed by regulation.

²¹ These reasons for intervention are discussed in the Commission Draft Impact assessment of a proposed Action Plan for Sustainable Industrial Policy and Sustainable Consumption and Production.

- where views in Europe differ on the standard
- where the preferences in Europe relate only to domestic production
- where they apply to global production irrespective of local effects

In each case we will look at the impact on producers, taxpayers, where relevant, and consumers, as well as the net impact on the community as a whole. We will also consider impacts on foreign producers and the impact of exporting the standard where preferences abroad are the same or different from domestic preferences or where absorption capability, for instance, for pollution which is different abroad.

We begin in Figure 1²² where we assume that the rest of the world can supply as much of the good as the home country (Europe) can absorb at the prevailing world price P_w , thus the supply curve is horizontal. This may be because European consumption is small relative to world production or because the rest of the world is producing at constant costs. European producers have a rising supply curve S , however, which indicates rising costs of production as the quantity produced increases. The domestic demand curve is D and there are no barriers to imports. Price is P_w , at which price domestic production is Q_0 , consumption is Q_w and imports are I_{P_w} . This is the base case for all that follows.

1.4.3 When all consumers agree on an externality

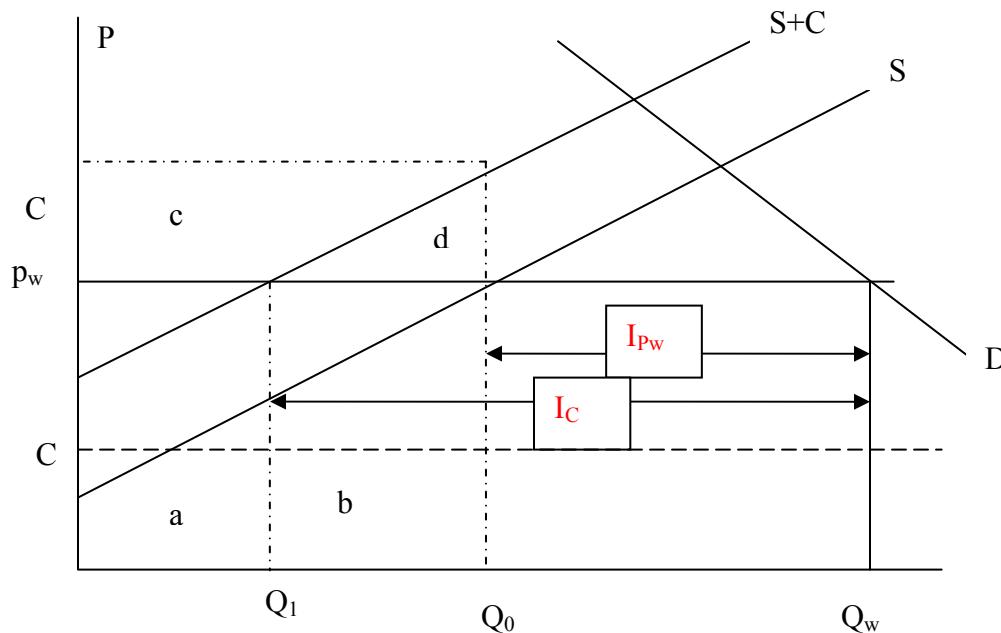
Now assume that there is an externality in production which only has local effect (i.e. only production in Europe imposes the externality on citizens of Europe); production overseas has no physical or psychic impact on Europeans. Assume further that all consumers in Europe uniformly value (homogenous preferences) the externality at $\text{€}C$ per unit of production, i.e. this is the amount they would be willing to pay to have the externality removed. Assume further, and to simplify, that $\text{€}C$ per unit also represents the cost to producers of correcting the externality. If they do so, this implies that removing the externality would shift the European supply curve from S to $S+C$ in Figure 1 as cost of production increases by C per unit.

An important distinction needs to be made here relative to the discussion of the labelling case. There the assumption was that people who cared for the standard were prepared to pay extra for goods that embodied it. Here we assume they are not! It is not that they do not value the standard, but that there is a co-ordination failure because of the public good nature of the problem. Because we treat the failure to achieve the standard as an externality, advocates feel disutility from every unit of consumption. Paying extra to achieve the standard on their own consumption makes only an infinitesimal contribution to their welfare if everyone else continues to violate it. Hence they are now no longer willing to pay extra unless they are assured that everyone will have to do so, and the problem will be fixed. Indeed, in the latter case, they would still rather that everybody else paid to

²² This draws on Brown, Drusilla K. & Deardorff, Alan V. & Stern, Robert M., 'Computational Analysis of the Economic Effects of an East Asian Preferential Trading Bloc,' *Journal of the Japanese and International Economies*. Vol. 10(1), 1996. pp 37-70.

achieve the standard and that, in their own personal case, they could buy the good at the original, standard-violating, price. This is the classic externalities analysis.

Figure 1: Local Externality at home in the production of an importable with homogeneous preferences towards the externality in Europe



Now let us introduce a regulation that requires producers to remove the externality in this fashion. Their costs rise to $S + C$ but price remains P_w , European production falls to Q_1 and imports increase to I_c . Consumption remains at Q_w because the price is unchanged. The value of removing the externality to consumers is C times the initial level of production; this is decomposed in the figure into part due to the fall in domestic production (b) and part reflecting the fact that remaining domestic output is externality-free (a). At the same time for producers face the cost (ϵC) of the achieving the standard on their initial level of output, i.e. the area represented by rectangle $c + d$. But since their production falls to Q_1 they save the excess cost over price on units $Q_0 - Q_1$ represented by triangle d , so in net terms they are worse off by c . Overall, Europe is thus better off by $a + b - c = d$.

Intuitively, the standard increases domestic welfare because it has eliminated the externality at home (in part by reducing domestic production and shifting resources to other more efficient uses), and European consumers import the rest of consumption which imposes no intra-EU local externality. This welfare calculus depends crucially on:

- all Europeans suffer from the externality (hence the ‘homogeneous’ label)
- there is no externality abroad, i.e. that no Europeans or foreigners experience an externality as foreign output rises; this essentially means that no-one gets any benefits

from the reduction of local externalities abroad – in effect, we assume that foreigners know what they like and they do not like the standard. We also assume here that EU consumers are not concerned about the impact abroad.

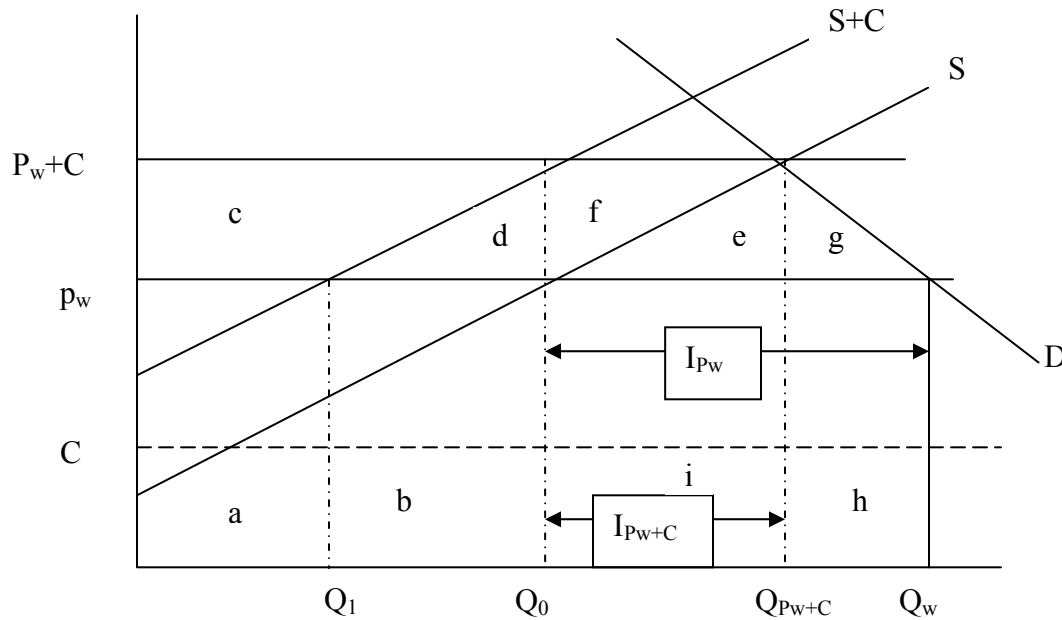
The analysis is the same for ‘real’ – that is, with actual or potential physical or economic effects on individuals, and for ‘psychic’ externalities, for instance, disgust, provided the latter are genuinely and universally held.

We can now relax the strong assumption of homogenous consumer preferences in Europe and allow for different preferences, such that some care about the externality and some – call them dissenters - do not. For the dissenters the standard just looks like a piece of cost-increasing bureaucracy. Their consumption position is not affected because imports fix the domestic price and they consume as before; However, they gain no benefit from removing the externality ($a+b$) while still observing the loss of surplus to producers of area c . The net loss to society, if everyone were a dissenter would be $-c$. Combining the two cases such that European society contains both carers and dissenters is simple. Assume that proportion θ of the population dissents: the analysis – figure 1 – is as before except that the benefit ($a+b$) must be reduced by the proportion of dissenters, θ . Now it is perfectly feasible that $c > 1-\theta(a+b)$, so that the standard is welfare-reducing in aggregate. Distributionally, carers would be better off and dissenters worse off.

1.4.4 A tariff to buttress the standard in Europe

We now move from consumer to producer concerns. If governments value all members of society equally, the analysis above defines the optimal policy: if the benefits outweigh the costs, impose the standard at home. But if producers have disproportionate weight in the local political process, they may be able either to demand compensation or to block a unilateral standard. The latter is essentially the argument about a race to the bottom, to which we turn below. To consider the former we consider the case in which the European authorities respond to producer dissatisfaction by imposing a tax on imports from abroad. This is explored in Figure 2. All the previous assumptions apply, preferences in Europe are homogenous and the externality is purely local.

Figure 2: A European Standard plus a Tariff, homogenous preferences



First, assume the tariff just equals $\text{€}C$, the cost of rectifying the externality. Import prices increase to $P_w + C$ and domestic production remains where it was (the tariff increases import prices to the exact price necessary to allow domestic producers to meet the standard while maintaining output). Consumption falls from Q_w to Q_{P_w+C} and imports fall from I_{P_w} to I_{P_w+C} . Consider first the comparison relative to the situation where Europe has a domestic standard, but no tariff, that is, relative to figure 1. Given that $(S+C)$ is, in fact, the ‘correct’ supply curve – it reflects the true social marginal cost of production allowing for the externality – we have the perfectly standard tariff story: consumers lose $c+d+e+f+g$; of this, c accrues locally as producer surplus and $e+f$ accrues locally as tariff revenue, so the efficiency losses are the triangles d and g . The former derives from the excess cost of producing units Q_1 to Q_0 at home (where they cause an externality) rather than abroad (where by assumption, they do not) and the latter from the consumption foregone. The tariff is harmful.

Comparing figure 2 with the pre-mandatory-standard situation, the welfare consequences are negative, but not so strongly so. Given the assumptions, imposing the standard generated welfare gains of $+d$ so the combined effect of the standard plus the tariff is $-g$. Considering the change directly, consumers lose $c+d+e+f+g$, but $c+d$ ($= (a+b)$) equals gains from removing the externality domestically and $e+f$ accrue to the government as tariff revenue.

If the tariff were set at a level different from the benefit from removing the externality, the analysis is similar. Suppose the tariff were set at a lower level. The consumer losses would

be smaller than previously, as would the tariff revenue gains, but the benefits from removing the externality would be the same. Hence the net effect could be positive. In the limit as the tariff approaches zero the gain relative to no policy at all must be positive, because we know from above that a homogeneous society has gains by addressing the externality through a domestic standard and the tariff-induced losses are avoided.

Of course, if European preferences are not homogenous, the case for imposing the standard is weaker and the tariff losses remain, so the case for the combined intervention is even weaker. The tariff does nothing to reduce the weakening effect that non-homogeneous preferences have on the case for intervention.

The point about QMA is that foreign suppliers who adhere to the standard are exempted from the tariff. If the cost of doing so is €C, exactly as in the EU and exactly the rate of tariff, figure 2 applies with just a little re-interpretation. Foreign suppliers have a choice of paying €C either in the form of standards compliance costs or taxes. The former entails real resource costs as €C per unit is transferred to foreign suppliers whereas the tariff generates revenues and so *ceteris paribus* would be preferable. But if Europeans experience disutility from the violation of the standard abroad (again assumed to be €C per unit), the equivalence is restored, for Europe either gains revenue in the tariff case or utility in the standards case.²³

1.4.5 Interdependent utility

We now move across the EU border and into the territory of the exporter, and assume that European consumers don't like the externality abroad, and hence have preferences about how goods are produced, both abroad as well as at home. Moreover, unless we make some explicit adjustment to counteract it, once we analyse policy within the context of such utility functions we are implicitly stating that it is legitimate for Europeans to seek to influence behaviour abroad in accordance with their own preferences. In some cases – e.g. gross violations of human rights – we may recognise an overwhelming moral imperative and feel justified in doing so. In other cases, however, we need to be sure that the objective is worth such interference and also that having once broken the taboo on such interference we are prepared to accept such interference back. If we impose tariffs to encourage foreigners to respect our views of animal welfare, are we prepared to accept their tariffs on, say, nasty video games which they claim encourage the corruption of our own children?²⁴

If we are prepared to move down this path, we should now assume that a unit of non-PPM production abroad imposes the same externality cost on European consumers as a unit of home production. Equivalently, we could move away from the economist's traditional

²³ The 'triple equivalence' assumption (consumer benefits in EU = producer compliance costs in EU = producer compliance costs outside the EU) is a very strong assumption, not likely to be achieved in reality but making the analysis much simpler.

²⁴ Given the huge economies of scale in producing software one could not deny the link between access to foreign markets and the incentives to produce games for domestic consumption.

assumption that individuals' preferences relate only to themselves (that is they are indifferent to the impact of the externality on others) and assume that we are concerned that foreigners enjoy the same water or air standards that we do, or that their animals suffer as little as our own in the production of food (whether for European consumption or not). This vastly increases the potential benefits from interfering with the market and in general reverses the signs on the net welfare effects discussed above. We will assume for now that these feelings extend only so far as the externality generated on production for the European market.

In that case, an EU domestic standard reduces European welfare because the increase in imports it generates just substitutes a foreign externality cost for the domestic one, with no change in the total. In Figure 1 rectangle b can no longer be considered a benefit since it now represents foreign externality instead of the domestic one. The net effect on externality costs is zero. Assuming linear schedules as drawn, the overall welfare effects of the standard thus become $a-c = -d$ rather than $a+b-c=d$. If the external cost is not affected by the policy, there is no point foregoing the producer surplus implicit in our being able to produce some units of the good more cheaply than the world price.

1.4.6 Introducing an EU standard plus a tariff

The standard plus the tariff now generates positive net welfare. Any production of the good (for the European market) imposes an external cost of $\text{€}C$ per unit and this needs to be counteracted by a tax. For the foreign producers, it is trade that creates the externality, for by assumption we are not bothered if they produce in non-PPM ways but sell elsewhere, so we tax trade – i.e. impose a tariff. For home producers we either tax the externality or, as here, eliminate it with an equally costly regulation. In terms of the figure, consumers lose $c+d+e+f+g$ but they gain $a+b+i+h$ (which net equals $\frac{1}{2}h$) in terms either of an externality eliminated or in terms of tariff revenue. Domestic producers are indifferent.

Lest this look like a cast-iron case for a standard and a tariff, let us recall that it relies on the assumptions that we care enough about how foreigners produce the goods that they sell to us that we are prepared to intervene and hence potentially legitimise their potential desire to interfere with our production processes, and that (perverse?) we don't care how they produce goods they sell to other people or consume themselves.

Also, of course, to the extent that Europeans were not uniform in their desire to impose this standard at home or abroad the case for intervention would be reduced. If European preferences are not homogenous either towards the domestic externality or towards the externality abroad then the benefits of domestic abatement of the externality are reduced by the proportion of $1-\theta$ as in earlier sections and value of eliminating the foreign externalities are reduced by $1-\theta$ plus some proportion ϕ of those who value elimination at home but not abroad, $\phi(1-\theta)$. Depending on the size of θ in particular (if θ is large it matters less how big ϕ is) this could reduce the benefits of elimination of foreign and domestic externalities

Returning to the simple case of homogeneous preferences, there is still a number of points about this analysis. First if the reason that the world supply curve is horizontal is that Europe is a small consumer with no impact on world prices, then it is at least plausible to assume that although European imports fall by $Q_w - Q_{w+c}$ world production does not fall and the externality may not be eliminated on even that small quantity of foreign output. That is, concern only for goods sold to Europe may do nothing to address the overall level of suffering or pollution abroad.

1.4.7 The QMA proposal

Introducing an EU standard plus an EU tariff plus hypothecation of the additional tariff revenue to help foreign producers meet the standard on exports to the EU

The proposal does two things, first it raises the existing tariff on imports of the product if they cannot be shown to meet the standard (this requires some form of credible testing and certification procedure in the exporting country). Second it hypothecates the revenue from the tariff on non-compliant imports to help foreign producers meet the standard.

The case of raising the tariff can be analysed using Figure 2²⁵ simply by assuming that the initial tariff is zero which is equivalent to the impact of an additional tariff of C per unit. Remembering that we have assumed that the size of the tariff C just equals the cost of removing the externality at home and abroad the impact of this is that the import receives the same price as home production ($P_w + C$) which would just be compensate for the cost of implementing the standard. In welfare terms Foreigners pay $+C$ in costs per unit but get the same in premium on the European market so they are neutral. European consumers get C or $(1 - \theta)C$ in welfare improvement per unit (depending on whether tastes are homogenous or not) or i or $(1 - \theta)i$ in total welfare improvement. Europe however loses C per unit of compliant imports in tariff revenue or $e + f$ which just compensates for the gain in welfare (i) from foreign compliance in the case of homogenous tastes. If tastes are not homogenous then Europe loses θC per unit in net welfare or $\theta(e + f)$ in total. Overall therefore imposing an extra tariff on non compliant goods just equal to the value of the externality and the cost of correcting it abroad, is at best welfare neutral and at worst reduces European welfare to the extent there are ‘dissenters’ in Europe. Note that in these cases there is no justification in using any form of subsidy to induce changed behaviour overseas. The tariff raises the domestic price just to the level that compensates the exporters for the cost of meeting the standard.

If the costs of compliance abroad are less than ϵC , say C_f in the exporting countries, they will increase exports at the expense of domestic producers until the price falls to $P_w + C_f$. Consumers will be better off because they would only have to pay an extra C_f to get something which they would be prepared to pay an extra C for. Consumption would expand because the price of standard-compliant goods had fallen to $P_w + C_f$. Overall Europe would be better off as consumers gain more than producers lose.

²⁵ The key difference here is that, if the foreign producer meets the standard, the tariff is not applied.

If compliance costs abroad were higher than in Europe and a premium of C did not compensate them for implementation costs then imports would fall and be substituted for by compliant domestic produce. Consumers would be no worse off and domestic producers better off because they would expand production to substitute for imports - because they are the lowest cost producers in the world of standard-compliant goods.

This last example might be a case to use any tariff revenue from residual non-compliant imports as a subsidy to encourage foreign producers to meet the standard. But note that once the countries that export to Europe meet the standard there is no case for the tariff. At which point the revenue to fund the subsidy disappears and with it the subsidy tied to the revenue stream. No subsidy, no incentive for foreign producers to meet the standard and back to square one. Thus QMA does not raise the revenue required to pay foreign producers to maintain the standard. At best it sets up an incentive that makes foreign producers indifferent between applying the standard and not doing so on their European sales. It would be better to decide on how much expenditure is needed to eliminate the externality and fund that from general taxation than from some arbitrary tariff.

Note also that the impact of hypothecating the tariff revenue to fund externality-free foreign production for export to Europe (which is a resource loss to Europe) is precisely compensated by the welfare gain of avoiding the externality on imports and will be at the expense of home production. There will be no race to the bottom but taxpayers will subsidise foreign at the expense of domestic compliant production.

Finally, there is no guarantee that foreign or domestic firms are homogenous in their ability to implement the standard. The cost of implementation C might actually be an average with some distribution around it of firms with implementing costs above and below C . Thus implementation of the standard will discriminate against firms with unit costs above C and in favour of those whose costs are below C . To the extent that small firms in Europe and abroad have higher unit costs of adjustment to the standard, SMEs may be damaged. This may be particularly so in developing countries where poorer and weaker firms are likely to be less able to adjust and the overall impact is likely to be regressive. Recent work by Humphrey²⁶ strongly suggests that, in Kenya for example, smaller farmers have particular difficulty in meeting the EU supermarkets' Eurepgap standards and that technical assistance is not successful in enabling them to do so. Other evidence suggests that small producers would be better off giving up their land and becoming wage labourers on the large farms which can generate the economies of scale to benefit from the Eurepgap standard.²⁷

1.4.8 Foreigners benefit from the standard too

The discussion so far has proceeded with no reference to foreign welfare or preferences at all. Suppose that we are wrong and that in fact foreign consumers like the standard too (at

²⁶ Humphrey, J. (2008) 'Private Standards, Small Farmers and Donor Policy: EUREPGAP in Kenya' Forthcoming IDS working paper.

²⁷ Swinnen, J., Vercaemmen, J., and Scott, R. 'Standards and Development' (2008).

least on their sales to Europe) and that foreign governments are wrong not to impose a standard. Then in Figure 2, even if they cared only about their local standards, foreign consumers would gain area i from our imposition of the standard on the goods they produce to export to Europe, and so they would be net gainers from the standard – exactly as in Figure 1 above, because the gain is C per unit on old production whereas the producer losses are less because output has fallen. If they also experienced an externality, they would also presumably gain from areas $a+b$ as we reduced our non-PPM production.

Above we assumed the compliance cost is equal for all producers around the world, but that may not be the case – foreigners might value the benefit of reducing the externality less but still more than zero. Or the costs of removing the externality may be objectively less. Some countries have a far higher carrying capacity for pollutants than others - e.g. plentiful water supplies, much space, etc. Then it may well be that the optimal standard abroad is weaker than that at home – i.e. $C_f < C_d$. This is a legitimate and efficient cause of comparative advantage and trade, and even if it irritates domestic producers that others are not ‘burdened’ in the way that they are, and that domestic output is smaller as a result, there is no economic case for intervention against imports in Europe to impose additional costs of $(C_d - C_f)$ to equalise the burden.

Legitimate differences in standards may partly reflect levels of development. For example, concern over visual amenity may be less for poorer people, or it might be that where schools are weaker and less available countries might have fewer restrictions on child/youth labour. In such countries efforts to stamp out formal child labour may lead to more informal labour rather than more schooling or play, and so be counterproductive. The analysis of $C_f < C_d$ can be conducted in terms similar to figure 2, but recognising that if the tariff is set at C_d , foreign producers will find it cheaper to satisfy the standard than pay the tariff and hence that the import price will rise by less than C_d and no tariff revenue will be collected.

In the cases above, if the foreign standard was optimally set initially and we insisted on its being raised, they lose. If they had standards that were too low (relative to their own preferences) initially, our imposition may move them towards optimality – exactly in parallel to figure 1 which dealt with domestic standards: producers may lose, but consumers (the general public) gain more. But this requires that we choose to impose the foreign optimal standards, which requires quite a large degree of confidence in European powers of analysis and benevolence.

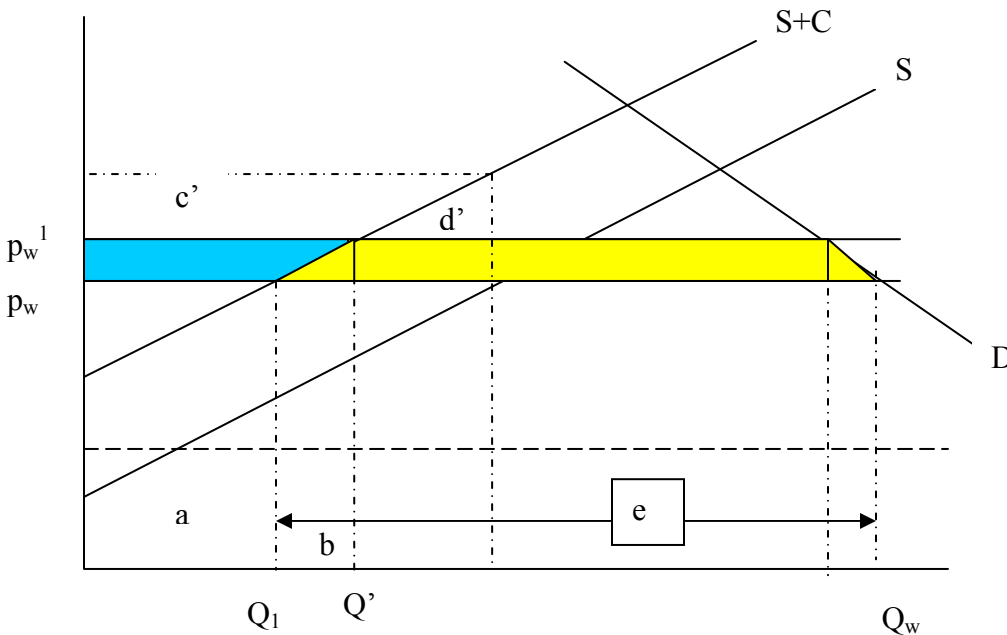
Consider now foreign standards with heterogeneous Europeans. In figure 2, rather than receiving national benefit $a+b$ from imposing a standard on foreigners, we receive only $1-\theta(a+b)$. The aggregate and distributive consequences are just as in the previous case.

1.4.9 Exporting the Standard

As we have noted several times, the idea that we object morally to suffering or pollution deriving from the goods that we consume, but not from the goods that others consume, does not seem very consistent. Nor, indeed is it consonant with the apparent desire of many

groups to change the world in their own image or the observable efforts of regulated industries to try to get similar regulations imposed on foreign rivals. Thus we ought to analyse the case in which the standard is propagated abroad. Figure 3 explores the economics of the successful export of the standard. It assumes again homogenous preferences and local benefits from the standard only. Assume also, for exposition of the best case for producers, that the standard can be exported uniformly across the rest of the world.

Figure 3: European Standard Exported, Domestic Preferences Homogenous



Starting from the initial equilibrium in figure 1, the first thing that happens is that costs rise globally by C (the cost of correcting the externality at home and abroad) and the world price rises to p_w^1 . It does not rise by the full amount, C , because global demand, and hence output, is cut back in response to higher prices; the new price is above P_w but below $P_w + C$. Local output is now Q' ; losses to local producers are now reduced to c' and the efficiency gain from cutting back on 'dirty' production is d' (less than d in figure 1), but consumers lose the blue (call it x) and yellow (call it y) areas in consumer surplus (dark and light grey areas respectively if printed in black and white). The blue area is the transfer to producers so producers are better off by x compared with a purely local standard. The net cost to Europe of adding in the foreign standard is the yellow area, y , which comprises a terms of trade effect (i.e. the increase in the world price) which is a the rectangle - and efficiency losses as domestic resources are pulled into production of the good (the yellow triangle under the supply curve) and to consumers as they lose the benefit of consumption at the old world price (the yellow triangle under the demand curve).

Relative to the initial position of a domestic standard but no foreign standard, Europe is worse off. Compared with the situation of no standards at home or abroad, the net impact may be positive or negative. The loss from adding the foreign standard could exceed the net gain from the local standard (area d in Figure 1). The net cost to foreign residents depends on whether they suffer the externality, whether they value it to the same degree as Europeans and whether the cost of implementing the standard is C . If some or all of these do not hold then foreigners would experience a loss of up to C per unit produced under the standard (which imposes a real resource loss on the rest of the world economy). Additionally, producers lose because, globally, output has fallen.

On the other hand, suppose in Figure 3 Europe gained from the reduction of the foreign externality on the goods it imports, consumers would also gain welfare of area e thus turning the net welfare loss in the base case into a benefit. In true public good fashion: if both 'we' and 'they' benefit from foreign attenuation, we should count the foreign e as a double benefit!

Further, if Europeans also benefit psychically from the abolition of the externality (which they value at C per unit) across all of foreign production then the benefits are much larger and would swamp all costs in Europe from higher world prices. However if foreigners valued the benefits of abolishing the externality at less than Europeans, and in the extreme at zero, this would likely (depending on relative populations of Europeans and foreigners and how different valuations of C are) far offset the benefits of the new global standard to Europeans and generate a negative global welfare effect. Europeans may feel the full benefit of eliminating the externality globally (we like to preserve a particular kind of moth) but foreigners just feel the cost.

1.4.10 Summary and conclusions

1. If the benefits of the PPM standards are internal to individual consumers, then voluntary labelling is enough. Consumers will be willing to pay the premium price required to eliminate the process they don't like in their own consumption.
2. For labelling to be effective it needs to be credible which might require compulsory regulation of accreditation and certification.
3. If there is an externality arising from the absence of PPM standards (whether physical or psychic) for anyone's consumption anywhere, then there is a case for a mandatory standard.
4. The economic welfare effects of different approaches to a standard and whether or not to try to make foreigners comply depends on a number of conditions notably:

- a. Whether EU preferences are homogenous or not. If not everyone values the externality to the same degree the benefits of fixing it are less.
 - b. Whether we value the externality only domestically or whether we also value the externality in foreign production.
 - c. Whether we care about the externality wherever it appears and irrespective of who is consuming the output.
5. Finally there are a number of potential policy responses
- a. a domestic standard with no policy on imports
 - b. a domestic standard and a tariff
 - c. QMA
 - i. Tariff rebated for compliant imports
 - ii. Tariff rebated and tariff revenue available to help foreign firms to adapt to the standard
 - b. Exporting the standard to the rest of the world

What follows from the above is that in cases where labelling is not effective:

1. Applying a standard will increase welfare if the population as a whole give a positive valuation to the removal of the externality at home only; if they value externalities abroad equally to those at home welfare will decrease.
2. A tariff will reduce welfare unless the population as a whole values removal of the externality on imports equally to the externality on domestic production.
3. A tariff preference for compliance abroad will shift foreign production to standard-compliant goods but only at the cost of higher prices to the consumer and the welfare effect is neutral.
4. Full QMA of tariff preference plus using tariff revenue to subsidise compliance to the standard double-compensates foreigners unless compliance costs overseas are higher than in Europe.
5. Even if compliance requires subsidy as well as the tariff preference, doing so from tariff revenue is inefficient; if all imports are compliant then tariff revenue will disappear and there will be none left to subsidise compliance and then trade will revert to non-compliance.
6. If a subsidy is necessary it is better to do so out of general revenue.

1.5 The QMA financing proposal

The QMA proposal seeks to levy additional duties on imports of food and agricultural products that do not comply with the relevant EU production standards in these domains. What is peculiar about the proposal is that it includes ideas on how to use the assumed additional tariff revenue for the benefit of upgrading production quality standards for sub-standard producers in developing countries – rather than leaving it as an integral part of the EU's general tariff revenue. We first cite some of the available references to such a financing mechanism in QMA documents and then discuss a number of characteristics and implications of this mechanism.

The Ecofair papers are the only statements available that refer to a financing mechanism on QMA:

*'Standards should be considered for defining possible charges to be applied at national borders. Instead of plain tariffs on price levels, QMA suggests differentiated charges according to environmental and social criteria. These charges may be gathered in an international rural development fund (IRDF) which redirects the increasing share of international trade profits into structural aid for rural development and the maintenance of local production resources.'*²⁸

Lorenzen notes:

*'A fundamental first step for the establishment of the IRDF fund is to elaborate a survey of potential beneficiaries, vulnerable groups, and disadvantaged regions. A second step would then be to identify the products, sustainable food security practices, and infrastructure needed to create added value for these groups and the regions most in need.'*²⁹

And

'The proposed International Rural Development Fund is the innovative investment part of the Qualified Market Access concept. It is fuelled by charges imposed on imports which are below a country's quality standards.'

The Slow Trade Report³⁰ makes a slightly looser link:

'Charges imposed on socially and environmentally destructive practices and products should then be turned into development aid and made available to regions and specific producers to support food security and sustainable rural development measures.'

²⁸ Ecofair 'Slow Trade – Sound Farming A Multilateral Framework for Sustainable Markets in Agriculture' http://www.ecofair-trade.org/pics/en/brosch_ecofairtrade_el.pdf

²⁹ Lorenzen 2007. *op cit.*

³⁰ Ecofair 'Slow Trade – Sound Farming. *op cit.*

'Sustainability standards at the border would work like trade filters to reduce social and environmental dumping. Governments could provide a 'carrot' to sustainable producers and grant preferential market access to products that adhere to certain sustainability standards. In other words, commercial goods that have been demonstrably co-produced along with common environmental and social goods would be given a trading advantage, thus encouraging a shift in production and marketing towards eco-fair commodities worldwide.'

But having acknowledged that this would not be popular in 'the South' the financial mechanism is added as possibility:

'This problem could be addressed by establishing a funding mechanism linked to the introduction of standards at the border. Revenues generated from managing market access in richer countries would be earmarked for a fund that would be channelled into structural aid for the promotion of sustainable rural development in marginal regions.¹²⁹ In this way tariffs applied to socially and environmentally harmful practices and products would be transformed into aid for sustainable rural development programs. Equivalent to the existing Global Environmental Facility (GEF), a 'Sustainable Rural Development Fund' comprising both governmental and non-governmental organizations could establish criteria and support mechanisms that would facilitate the transition towards sustainable farming practices as well as the implementation of qualified market access schemes in the South.'

The above citations give only a vague impression of the modalities of the proposed financing mechanism. Many questions remain unanswered. There are no indications in the available documents on QMA on the magnitude of the additional tariffs for non-compliant food and agricultural products. Should tariffs be raised up to the level of PPM compliance costs in the EU (to provide effective price protection against regulatory competition)? Or should they be raised up to compliance costs in the exporting country (to provide an incentive for exporters to invest in compliance)? Or should they be raised up to the level of consumers' willingness to pay for these PPM characteristics?

It is not sure if an additional import levy would actually increase tariff revenue. Market conditions for the products affected may be such that the additional levy would effectively impede or significantly reduce imports, which would result in an overall decrease rather than an increase in revenue. This would require a complex statistical analysis to determine the actual change in revenue caused by this additional levy. Also, it is unclear whether the entire tariff revenue for the imported non-compliant good would be put into the proposed fund, or only the additional revenue, if any. If the QMA proposal would seek to raise MFN tariffs above bound rates, WTO rules would require payment of financial compensation to the countries that lose out; all additional revenue might well be absorbed by that.

Would the proposed fund be a parallel financing mechanism to already existing EU development aid, or should it be merged with existing aid funds? Merger allows better coordination; parallel funding would make that difficult. Creating a parallel fund would go against basic and widely accepted principles of good governance of development aid. A parallel fund would also go against the principle of unity of the budget, earmarking (part of the) tariff revenue for a specific purpose rather than allocating it to general fiscal revenue. That is not conducive to proper management of public finances. Some documents suggest that the EU should hand the revenue from its QMA tariffs to an international body that would then disburse the money, thereby reducing donor control over spending.

The proposed mechanism would put policy makers and fund managers in a dilemma, being confronted with two conflicting policy objectives: should they promote the imports of non-compliant goods to increase revenue and thus increase assistance to below-standard farmers in developing countries? Or alternatively, should they discourage imports and thereby reduce funds available to help non-compliant farmers upgrade their production standards?

There are no indications on how the funds should be allocated to beneficiaries: should the grant aid or subsidies be allocated to countries or directly to individual producers (thereby by-passing the authorities)? If, for instance, it was handed over to governments on the basis of non-verifiable commitments to make general obligations to increase spending on rural infrastructure, then this would be quite different from automatic financial support for products made using 'sustainable food security practices.' Would this reward farmers who could meet QMA standards, or support those who could not? If the subsidy is handed to those who do comply then they are given a double premium, the tariff preference and the bonus. The incentive effects would be very different. Should aid be given to farmers who are in a position to upgrade their production standards with purely commercial financing, or only to those who have no access to such financing?

It is extremely unlikely that the amount of aid needed to support sustainable rural development would coincidentally be exactly the same as the amount of revenue brought in by the additional tariffs. Selection criteria for allocation on the basis of merit would thus be desirable. If not the allocation process becomes discretionary and incoherent. Sound economic reasoning suggests that if the cost of upgrading production standards does not pay off in terms of a market-based export price premium, it would be welfare-diminishing for businesses to push ahead with the upgrading unless they receive a subsidy to make up for the difference. Poor allocation criteria could greatly reduce the welfare benefits of such a fund. Countries that had the most sustainable practices would be likely to benefit least from the funding mechanism. There could be quite significant distributional consequences between countries and between producers depending on what arrangements are made.

In view of these uncertainties and the large number of unknown parameters in the proposed QMA system, it is more important to examine the issue of how costly it would be for developing countries to comply with EU norms and what evidence there is available on consumer preferences and welfare benefits. It is worth stressing that the most important cost of a QMA scheme would not necessarily be the direct cost of compliance and the

impact on consumer welfare, but rather the systemic impact on the world trade system if the EU unilaterally adopted such a measure in the face of opposition from partners.

Chapter 2. Assessing the Empirical Evidence

The theoretical economic analysis argued that the economic impact of QMA would depend on the compliance costs for the norms required by the EU and the preferences of EU consumers. Further analysis is hampered by the fact that there is no clear indication of the precise set of rules that the QMA proposal is designed to sustain.

In this section we look at the empirical evidence available on compliance costs and consumers' willingness to pay for specific production process characteristics. We first look at the evidence on compliance costs within the EU with the set of norms that have attracted particular attention as potential sources of loss of competitiveness, namely the SMR and GAEC cross-compliance conditions for the single farm payment. We find that these rules have a very modest impact, if at all, on EU competitiveness. We then look at the other side of the coin, namely the costs of compliance for developing countries with a variety of EU generated rules, notably (voluntary) production process norms in the Eurepgap scheme. We then review some studies on the overall impact of differences in environmental norms on trade and investment to assess the evidence for 'race to the bottom' effects. Finally, we review the evidence on the competitiveness implications of labour standards.

2.1 Costs: Compliance costs within the EU

We begin our discussion with a review of the evidence on the costs of compliance within the EU of environmental and other standards and their impact on competitiveness. A major concern of the proponents of QMA is that requirements, particularly those of cross compliance, are undermining the competitiveness of EU agriculture. Further, that the failure of our trading partners to adopt such standards leads to pressure for us to reduce EU standards.

Data on the costs of compliance with EU environmental regulations are not easy to come by. Studies have been carried out under the Sixth Framework programme of the competitiveness impact of the recent changes in the EU's environmental rules as they affect farmers. The most comprehensive study we have found is 'Compliance with standards and competitiveness: an assessment for selected agricultural products.'³¹

This study highlights a very serious methodological question: what is our counterfactual? Do we consider the competitiveness impact of the whole EU environmental acquis or of the additional costs imposed by the cross compliance system? And how do we allow for the fact that farmers receive subsidies for compliance? Should these subsidies be treated as an exogenous entitlement or an offset to the costs?

³¹ Roel Jongeneel. Summary report for CROSS-COMPLIANCE project, EU 6th Framework Programme, Priority 8.1 (European Commission, DG RTD, contract no. SSPECT-2005-006489).

This extensive study is summarised in an appendix. The bottom line is that the *direct* effects on EU competitiveness of the cross compliance rules appear to be quite modest:

*'Aggregating all trade balance impacts generates a total reduction in value of the considered products and measures of 373 million dollar.'*³²

However when the *indirect* effects on the rest of the economy are taken into account in a general equilibrium framework, than the effects actually become positive according to this study:

'Moreover, when looking to the overall trade balance impact, taking into account the spill-over effects to other sectors (e.g. food industry, etc.) in the EU economy, the net impact is almost zero. These latter spill-over or indirect effects [...] reflect internal competitiveness effects (i.e. changes between the relative position of different sectors like the food sector, the manufacturing sector, etc.) within the EU economy. As the Table shows these effects appear to be positive and largely compensating for the direct effects experienced in the primary production sectors.'

It should be stressed that these conclusions only address the impact of the recent tightening of rules and their enforcement.

The position of the poultry sector is sometimes highlighted as potentially vulnerable to low cost-low standard imports. We therefore sought evidence on this. The work of van Horne and Bondt³³ appears to be the most exhaustive. It does look at the overall impact of the welfare directives for egg farming. They too argue that it is mainly trade in egg powder that is likely to be affected by animal welfare rules. Unlike Jongeneel et al, this study does look at Brazil and Ukraine. They note that at the time of writing in 2003 there was a heavy tariff on the import of eggs that was due to be reduced. However the same measures of agricultural liberalization which lower tariffs on eggs would also lower the costs of feed for EU farmers. The net result is that for shell eggs, Poland - after accession and paying EU animal welfare costs - remains the lowest cost supplier for eggs into Germany in 2012 under virtually all the scenarios they explore:

*'The results of the scenario calculations show that in a competition on the German market for shell eggs Ukraine, USA, Brazil and India cannot compete on price.'*³⁴

The calculations suggest that, Brazil and India could be competitive only with very substantial reductions in tariffs and a fall in the exchange rate of all non-EU currencies. Poland remains competitive on many assumptions for egg powder in 2012, but a combination of animal welfare cost increases tariff cuts and exchange rate depreciations could in 2012 put Brazil and India ahead. They note that for shell eggs:

³² *Ibid.* p. 84

³³ van Horne P.L.M. and Bondt, N. 'Impact of EU Council Directive 99/74/EC 'Welfare of laying hens' on the competitiveness of the EU egg industry.' 2003.
http://www.lei.dlo.nl/publicaties/PDF/2003/2_xxx/2_03_04.pdf

³⁴ *Ibid.* p. 43.

*'In 2000 a study was conducted on the future position for Dutch table eggs. In combination with a desk study, interviews were held in the Netherlands and Germany at egg packing stations and retailers. The main conclusion in this report was that retailers strongly prefer locally produced table eggs. Particularly regarding aspects such as freshness, food safety and traceability EU eggs are far ahead of eggs produced in non-EU countries. In the same report (Tacken, 2002) it was concluded that non cage eggs have a future.'*³⁵

They do also observe however that this trend may not continue. Their use of the GTAP model assuming a 13% cost increase due to animal welfare rules leads to the conclusions that the results show an 11.4 and 4.2% decrease in production volume in respectively North Europe and South Europe. It is relevant that one study noted:

*The costs of upgrading animal farming to higher standards in developing countries have not been well researched.... 'It has been estimated that [within the EU] the production cost of chickens ('broilers') increases by 5 per cent if the stocking density is decreased from 38 to 30 kg/m². The same increase applies for slower growth of broilers (from 40 to 50 days).'*³⁶

2.2 Compliance costs outside the EU

It is less easy to explore the impact of EU PPMs applied in developing countries since to date the EU mainly requires only SPS rules to be applied. We find ambiguous conclusions. Many countries have successfully adapted to EU requirements but it is easier for larger farms and richer countries. Studies of trade effects are ambiguous.

There are a number of studies of compliance costs with EU SPS standards; since there are no studies on PPM type measures, we take SPS measures as a proxy for compliance costs on PPMs. While this is a somewhat different subject, a recent World Bank Study on Morocco³⁷ concludes that the compliance costs are likely to fall very much into the realm of monitoring, so PPM rules costs may be of similar orders of magnitude to SPS ones.

³⁵ *Ibid.* p.44.

³⁶ Van den Bossche, N. Schrijver and G. Faber. *Unilateral Measures addressing Non-Trade Concerns*. A study on WTO Consistency, Relevance of other International Agreements, Economic Effectiveness and Impact on Developing Countries of Measures concerning Non-Product-Related Processes and Production Methods. The Hague: the Ministry of Foreign Affairs of The Netherlands. 2007. p 236

³⁷ Omar Aloui and Lahcen Kenny 'The Cost of Compliance with SPS Standards for Moroccan Exports' siteresources.worldbank.org/INTRANETTRADE/Resources/Topics/Standards/MoroccoCountrySurveyF.pdf

Table 1 Cost of compliance with the EUREPGAP standard (tomato farm) US \$ (US\$1 = 9.11 MAD.)³⁸

<i>Items</i>	<i>Cost for 10 ha</i>		<i>Cost/ha/year</i>	
	<i>US\$</i>	<i>% of total</i>	<i>US\$</i>	<i>% of total</i>
1. Building and facilities	\$33,974	47.8	\$170	6.8
2. Equipment	16,959	23.9	339	13.4
3. Technical assistance	5,269	7.4	527	20.9
4. Training	1,317	1.8	132	5.2
5. Monitoring and surveillance	9,221	13.0	922	36.5
6. Consumables	1,493	2.1	149	5.9
7. Certification costs	2,854	4.0	285	11.3
Total	\$71,087	100.0	\$2,524	100.0

What is striking about this estimate is the high cost of monitoring and surveillance, which would also apply to any PPMs. Other estimates have been made of costs of compliance with Eurepgap. Other estimates have been made of costs of compliance with Eurepgap, for example Van den Bossche, P, N. Schrijver and G. Faber (2007) p. 235.

Table 2.

Costs of complying with Eurepgap conditions in Tanzania, Mozambique Guinea (in US\$, 2005)

Country	Macro costs (x 1000)*	Micro: setup costs**	Micro: ongoing costs**
Tanzania	2520	98,690	20,500
Guinea	3142	2,197,200	27,000
Mozambique	9250	109,400	23,600

* at the national level

** at the level of the firm

It is important to distinguish the element of certification versus direct costs of compliance. It seems likely that for those who comply with the costs of certification and monitoring of any QMA norm would be similar to that of the monitoring and surveillance costs of the Eurepgap scheme. The Eurepgap scheme is voluntary from a legal point of view. Hence the certification costs could be similar to those of other schemes. To be credible certification has to be done by an international conformity assessment entity. These are either private firms such as SGS or the commercial arms of developed country standards institutions operating.

³⁸ Source see footnote 36.

It is difficult to actually evaluate the impact of this on trade and production overseas. The evidence is highly controversial.³⁹ One study estimated that requiring West African exports to comply with EC aflatoxin MRLs that were tougher than Codex rules could reduce their exports by 60%.⁴⁰ This estimate has been disputed however by Henson and Jaffee who argue that the price premium available for ‘fair trade products’⁴¹ has been omitted. However we can make a number of qualitative observations. Although we have no estimates of the compliance costs for QMA rules we can tentatively speculate that the certification costs will be comparable to those we have identified above. There is likely to be a big variance among producers. The existence of high fixed annual costs for certification is known to be very burdensome on smaller farmers, unless they are able, as is possible for Eurepgap to secure certification as a group. Hence there is likelihood that QMA type schemes would penalise small farmers most. They note:

‘Even where the administrative, technical and financial burden of compliance with enhanced standards is achievable at a country or industry level, this burden may be too great a burden at the level of individual firms or producers. There is a general concern that the challenge of rising standards is marginalizing the position of smaller players, especially producers, traders and processors, as well as smaller industries as a whole, in international trade.’⁴²

Larger commercial farmers would thus be both less impacted by QMA tariffs and more likely to be eligible for aid to upgrade. This point is stressed by Humphrey in a study of Kenya where he argues that development agencies have made major errors in their response to the demands of the European supermarket Eurepgap system.⁴³ Firstly, the costs must be considered not simply in relation to the farmer but the overall supply chain. Much of cost of compliance with tougher standards is borne downstream by traders and exporters. However they will only be prepared to do this if it is commercial viable and they will only pay what is needed to keep their export markets open when they are dealing with the producers most capable of meeting the standards. Donor agencies have invested in assisting small farmers obtain certification for Eurepgap standards but this is often futile because they cannot actually meet the standards. QMA norms might further privilege the position of larger commercial farmers in supply chains. Meanwhile another study on fisheries argued:

‘What is worse is that environmental standards may actually result in the cartelization of a number of industries and sectors. For example, an environmental directive in several developed importing countries, led to the shrinking of fisheries exporters in India from nearly 400 to merely 100. This was because a number of small-scale fishermen could not comply with the standard and were forced out of

³⁹ see Jaffee and Henson. “Standards Agro-Food Exports from Developing Countries: Rebalancing the Debate” 2004.

⁴⁰ Otsuki et al “Saving Two in a Billion: Quantifying the Trade Effect of European Food Safety Standards on African Exports.” 2001

⁴¹ For exact definitions of Fair Trade see http://www.fairtrade.org.uk/what_is_fairtrade/default.aspx

⁴² Henson and Jaffee, 2004

⁴³ Humphrey, J. *Op cit.*

*business. In this case, the environmental standard actually had an impoverishing effect.*⁴⁴

Generally speaking developing country spokespersons argue strongly that all upgrading of EU norms is to be resisted, although more advanced middle income countries will probably find it much easier to deal with rules than poorer countries.

2.3 Price premia

As our conceptual analysis suggests that a QMA approach imposes losses on consumers if they do not prefer 'sustainable' products. However, if they do have this preference, there is a gain in welfare for consumers in the EU. The strength of consumer preferences can be measured through price premia. There are a number of studies of the potential price premia obtainable from eco-friendly products. These fall into three types:

1. Those which use actual data to assess quality premia obtained in the market-place, whether by simply direct observation or by econometric inference
2. Surveys of stated willingness to pay
3. Experimental results

The first type is the most reliable, but hardest to find. In addition there may also be gains in volume terms to producers if they are able to obtain price premia or guaranteed market access which more than compensates for the cost of compliance. Estimates in the study by Van den Bossche, Schrijver and Faber do look at actual prices. They suggest that within the EU animal welfare costs can be recovered in the form of a higher price:

'Free-range chicken breast fetches a much higher price premium, which may be as much as 50 per cent.'

*'Complying with animal welfare standards may increase the cost of pig production in the UK by approximately 10 per cent (free range compared to minimum standards), which is covered by a price premium.'*⁴⁵

But the difficulty of interpreting such data can be seen by a glance at the www.tesco.com website. A comparison of prices for 'fair trade' and non fair trade coffee reveals that there are multiple grades of each and one would actually need a full hedonic price index to make comparison. Given the lack of definition of the QMA standards we assume that goods certifiable as 'fair trade' are likely to pass QMA rules⁴⁶. We can observe that for ground

⁴⁴ Jha, V. ICTSD Trade and the environment a resource book., p.182 2007. http://www.trade-environment.org/page/southernagenda/RB_fulltext.pdf

⁴⁵ Van den Bossche, P, N. Schrijver and G. Faber (2007) *Unilateral Measures addressing Non-Trade Concerns*. A study on WTO Consistency, Relevance of other International Agreements, Economic Effectiveness and Impact on Developing Countries of Measures concerning Non-Product-Related Processes and Production Methods. The Hague: the Ministry of Foreign Affairs of The Netherlands. P 236.

⁴⁶ For exact definitions of Fair Trade see http://www.fairtrade.org.uk/what_is_fairtrade/default.aspx

coffee the price of fair trade ranges from about 90p/100g to 130-140p/100g while the price of non fair trade coffee ranges from 72p to 130+p/100g. On the other hand prices per kg of chicken range from £2.15 for 'value chicken', the production conditions for which we do not and might wish not to know, up to £5.99 for organic. But in both cases there would be product characteristics as well as process ones that determine willingness to pay. Nor do we know how many consumers are willing to pay the premium price. An attempt to view supermarket websites actually reveals more about the problems of price comparisons than it does about actual price differences.

A UNEP study cites an article in the UK Sunday Times in 2003 on fair trade:

<i>Average supermarket price (pence/kg):</i>	
<i>Regular bananas:</i>	80p
<i>FairTrade bananas:</i>	154p
<i>Price difference:</i>	74p
<i>Paid to Third World farmers:</i>	24p
<i>Additional supermarket income:</i>	50p

The same UNEP study observes that the apparent market share of fair trade labeled products is extremely small:

*'While the rate of growth in fair trade markets is significant, overall market penetration by fair trade products is relatively insignificant. For example, the relative proportion of total world trade for any single commodity listed is no greater than 0.2% (bananas, 2000). The volume of fair trade sugar increased by 38.8% between 2001 and 2002, but the total volume represented less than 0.0019% of global sales.⁴⁷ The total value of certified sustainable coffee sold in 2000 is reported to have been US\$ 565 million, or roughly 1% of the global coffee market.'*⁴⁷

It also quotes studies on the share of 'organic' products. For most European states the share of organics is 1.5-2.5% of total food sales, with a maximum of 3.7% in Switzerland. Narrower estimates for fruit and vegetables suggest a range of about 3-10% of sales.

There are numerous studies of eco labelling, though relatively few recently. A recent European Commission report notes:

*'While those using the scheme point out the positive environmental benefits they have brought, and while the scheme continues to grow steadily with around € 800 million of sales of eco-labelled products, it still commands a very small EU market share in relative terms'*⁴⁸

⁴⁷ UNEP Assessment and Response. The Trade and Environmental Effects of Ecolabels. 2005. p23

⁴⁸ Impact Assessment for the Revision of Regulation (EC) No 1980/2000 of the European Parliament and of the Council of 17 July 2000 on a revised Community eco-label award scheme. , p15

There are national schemes with larger impact but the message remains that they have a limited impact. Galarraga (2002) surveyed studies of the impact of eco labelling but he does not provide comprehensive data, rather offers some indication of price premia.⁴⁹ We have included a table reproduced from his paper in the Appendix where the sources used in each study have been noted. A number of points are worth noting. There are relatively few recent studies; most studies are done by survey; and there is a high degree of variance. He notes that most are based on surveys. Exceptions included his own work estimating a premium of 11.23% for the fair trade/organic label in the UK using econometric methods on actual price data; an econometric study of the premium on organic cotton estimating a premium of 33.8%⁵⁰ and a study of fair trade wood products estimating premia of 21–23% for the UK, and 12–14% for a Norwegian sample.

Caswell and Joseph also reviewed a series of studies on the willingness of consumers to pay for attributes of food that are labelled but are not mandatory.⁵¹ They find that the research to date leaves many questions open. There are considerable variations between studies and between estimates of willingness to pay for different characteristics. There are also systematic variations between types of consumer, the better educated being more willing to pay extra. In general, consumers are willing to pay more for what they see as safer products but surveys also suggest, as in the examples above, a willingness to pay extra for animal welfare. They do not report on willingness to pay in the EU but US' and Canadian studies suggest a willingness to pay 16-20% more for beef and pork certified as avoiding animal ill treatment. They conclude that there is great uncertainty

*'To conclude, in most studies it has been found that consumers are willing to pay for food safety, and, importantly for information that they believe provides food safety assurance. However, willingness to pay in these studies is contingent on certain factors such as consumers' age, income, demographics, and the method the study used.'*⁵²

This conclusion is echoed by a UNEP study:

*'The research undertaken for this report has made it clear that there is not enough concrete evidence to determine what the effects of ecolabels are on the environment, trade flows or market access for particular products.'*⁵³

Therefore without more information about the exact measures being proposed under the QMA scheme we cannot be more precise about how far the costs of QMA requirements

⁴⁹ Galarraga Gallastegui, I. 'The use of eco-labels: a review of the literature' European Environment Volume 12 Issue 6, 2002. pp. 316 - 331.

⁵⁰ Nimon W and Beghin, J. Are ecolabels valuable? Evidence from the apparel industry. American Journal of Agricultural Economics. 81. 1991.

⁵¹ Caswell, J. and Siny, J. 'Consumers' Food Safety, Environmental, and Animal Welfare Concerns: Major Determinants for Agricultural and Food Trade in the Future?' http://www.ilr1.uni-bonn.de/iatrc/iatrc_program/Session%205/Caswell_Joseph.pdf

⁵² *Ibid.* p 9

⁵³ UNEP (2005) The Trade and Environmental Effects of Ecolabels: Assessment and Response www.unep.ch/etb/publications/Ecolabelpap141005f.pdf, p.ii.

would be willingly paid by consumers. Even where information exists there is considerable variation in the premium and the share of consumers willing to pay the premium. It is also worth noting that there may be variation across time. Ronchi undertook an extensive analysis of the fair trade coffee market and observes that part of the aim is to stabilise prices so that the premium varies with the state of the world coffee market, with a floor of 5 US cents/lb when the market price goes above the target fair trade price.⁵⁴ Many of the premia are based on the existence of a small niche market which commands higher prices. We cannot infer that the premium reflects willingness to pay for the whole of the market. Indeed hard data can only ever exist where eco-friendly and other products co exist.

Finally, the impact on profitability needs to be assessed rather than the pure price premia as such. There is a fairly extensive literature on the impact of higher standards on developing country exports. The much cited study by Otsuki et al (2001) on the EU aflatoxin norms created a major concern. Since then opinion has moved from alarmism towards the view that in some cases higher standards can be facilitators for quality upgrade. The key question is, under what conditions. It is customary to argue that the effect of higher standards is in variably most negative on the poorest farmers. We have referred earlier to this issue. It seems quite strongly established that small farms can typically not meet higher standards, for example, as set by supermarkets. Research by Anders and Caswell suggests that the barrier effect is indeed strong in the case of US SPS measures on seafood.

*'A surprisingly clear pattern of individual country trade responses emerges based on the pre-HACCP size of the country's seafood exports to the United States. The larger exporters gained from the introduction of stricter food-safety regulations. Twelve of the top 15 suppliers of seafood to the U.S. had strictly increasing trade flow patterns in the short- and long-run post-HACCP periods. In contrast, ten of the 18 smaller exporters experienced negative short- and long-run HACCP effects, while an additional 4 experienced a negative long-term effect.'*⁵⁵

However, a further aspect of the debate relates to the issue of standards as barriers vs. standards as facilitators. Jaffee and Henson argue:

'From this 'standards-as-catalyst' perspective, the challenge inherent in compliance with food safety and agricultural health standards may well provide a powerful incentive for the modernization of developing country export supply chains and give greater clarity to the necessary and appropriate management functions of government. Further, via increased attention to the spread and adoption of 'good practices' in agriculture and food manufacture, there may be

⁵⁴ Ronchi, Loraine (2006) "Fairtrade" and Market Failures in Agricultural Commodity Markets World Bank Policy Research Working Paper 4011

⁵⁵ Anders, Sven and Julie A. Caswell. Assessing the Impact of Stricter Food Safety Standards on Trade: HACCP in U.S. Seafood Trade with the Developing World. Selected paper presented at the annual meeting of the American Agricultural Economics Association, Long Beach, California, July 2006, P.19

*spill-overs into domestic food safety and agricultural health, to the benefit of the local population and domestic producers.*⁵⁶

They are generally referring to mandatory standards but similar arguments are relevant where market demand via the need for labels is present. They see the process driven by supply chains. They do however caution that there will be losers as well as winners. In the case of agriculture, the impact on poor farmers is not necessarily the same as that on small farms. Swinnen et al various studies⁵⁷ find, like Humphrey,⁵⁸ that it is often hard for small farms to meet enhanced supermarket standards, though they argue these adverse effects may be offset by the impact of better access to credit, and so on.

'The rise of contracting, far from leading to the exclusion of poorer farmers, is shown to improve access to credit, technology and quality inputs for poor, small farmers that heretofore were faced with binding credit and information constraints due to poorly developed input markets.'

However their analysis of value chains standards plus tighter standards is not far removed from Humphrey. They argue that even if small farmers are excluded this is not the same as a regressive effects on poverty. Swinnen's work in Senegal and Madagascar suggests that net effects depend on initial conditions and that one cannot generalise. Agriculturalists can actually become better off by abandoning sub-contracting for supermarkets and switching to paid employment on commercial farms.

*'Tightening food standards induced a shift from smallholder contract-based farming to large-scale integrated estate production, altering the mechanism through which poor households benefit: through labor markets instead of product markets.'*⁵⁹

Thus to summarize, the evidence on the willingness of EU consumers to pay more for high standard compliant food is incomplete and ambiguous. High grade food can sometimes command a premium but we do not know how far premia could remain if a large share of the market were to be involved. Moreover, there is inconclusive evidence on who is able to take advantage of this premium and who is excluded.

⁵⁶ Jaffee and Henson *op cit.* Holmes, P; Iacovone L et al. 'Capacity-Building to Meet International Standards as Public Goods' UNIDO Working paper 2006. http://www.unido.org/file-storage/download/?file_id=60028

⁵⁷ Jo Swinnen, Jim Vercammen and Scott Rozelle (2008) 'Standards and Development' KUL.

⁵⁸ Humphrey. *op cit.*

⁵⁹ Miet Maertens and Johan F.M. Swinnen (2006) 'Trade, Standards and Poverty: Evidence from Senegal and Madagascar' KUL.

2.4 General studies of the impact of PPMs

The previous section reviewed studies on the specific competitiveness impact of EU norms in agriculture. There is a wider literature on the competitiveness consequences of environmental standards. This does not deal with agriculture and does not bear directly on the QMA debate but it is relevant to the general issue of environmental standards and competitiveness. Generally we find a picture similar to that emerging from the cross compliance analysis. There is a small increase in trade in pollution intense products from countries with lower standards but this is generally small.

The traditional approach is to explore the Pollution Haven hypothesis, namely that pollution intensive production gravitates to LDCs with lower standards. Most authors have found almost no evidence of Pollution haven effects. For example:

*'First, we find that a shift toward cleaner industries, similar to that observed in U.S. manufacturing, has also occurred among U.S. imports. Second, we find no evidence that pollution-intensive industries have been disproportionately affected by the tariff changes over that time period.'*⁶⁰

Some writers have found slight evidence of a 'Pollution Haven effect' in which developed countries relocate their sources of supply of polluting goods abroad. Given that many variables are involved in determining trade flows it raises some doubts.⁶¹ A recent study for the World Bank does find some evidence of 'pollution haven effects' in a model that looks at a large number of factors including factor endowment, but they argue that the effect is minor.⁶² Copeland and Taylor⁶³ acknowledge that environmental policies may affect trade but, as we shall see below, they argue that trade policy is not the correct instrument to address the issue even where we have preferences about foreign policies.

2.5 Labour standards

Even more than environmental standards, the research on the effects of labour standards in competitiveness are hard to pin down. Here there is very little evidence that poor standards bring competitiveness gains. Cross country studies⁶⁴ have consistently come up with the finding that no systematic relationship can be found between lax application of labour norms and competitiveness. We have been unable to find any studies specifically on agriculture. Martin and Maskus also argue that there is little evidence that lax labour standards increase competitiveness and that even where labour standards are sub-optimal

⁶⁰ Ederington and Minier (2003)

⁶¹ See also Frankel (2003), J.A, The Environment And Globalization Working Paper 10090. Located at: <http://www.nber.org/papers/w10090>.

⁶² Grether, Jean-Marie & Mathys, Nicole A. & de Melo, Jaime, 2006. 'Unraveling the worldwide pollution haven effect,' Policy Research Working Paper Series 4047, The World Bank

⁶³ Copeland, B.R. & Taylor, M. S. 'Trade, Growth, and the Environment' Jnl Econ Lit 2005.

⁶⁴ Rodrik, D. (1996), Labor Standards in International Trade: Do They Matter and What Do We Do About Them

tariffs would add a further distortion. They argue that absence of adequate enforcement of core labour standards is costly rather than providing an export advantage.⁶⁵ Another survey concluded:

*'Thus, the empirical evidence suggests that there is no basis for claiming that allegedly low labor standards in developing countries have a significantly adverse effect on wages in industrialized countries, provide developing countries with an unfair advantage in their export trade, or distort the geographic distribution of FDI between low and high standards countries.'*⁶⁶

Other authors argue similarly.⁶⁷ With regard to such considerations as labour standards extensive research has shown as Stern and Terrell argue:

'The imposition of labor standards that are too high (e.g., minimum living wages that are set above the level of labor productivity) will push more workers out of the 'formal' sector (which tries to abide by them) and into the 'informal' sector, thus exacerbating rather than diminishing the existing inequality in terms of wages and working conditions within the developing countries.'

Attempting to enforce these by trade sanctions is likely to increase informal employment. It is a standard finding that the best way to ensure children go to school is to pay families a bonus that compensates for loss of earning.⁶⁸ Corden and Vousden note in the context of labour standards that if low wages are due to monopsony power by employers and not low labour productivity it may be possible regulation to raise wages without affecting employment:

*'But an interesting paradox emerges once labour market monopsony is allowed for. If raising labour costs in LDCs' export industries did not reduce employment there because of labour market monopsony it would also not reduce exports and thus would not raise world relative prices of these goods. Hence it would not achieve the objective of the protectionists. On the other hand it might achieve the objective of the humanitarians, which is to raise wages and working conditions in LDC export industries while not reducing wages in the rest of the economy. What is welcome for the humanitarians is not good for the protectionists.'*⁶⁹

⁶⁵ Martin, W, and Maskus KE. Core Labor Standards and Competitiveness: Implications for Global Trade Policy. 2001. Review of International Economics 9 (2) , 317–328 doi:10.1111/1467-9396.00281

⁶⁶ Stern, R and Terrell, K., 'Labor Standards And The World Trade Organization. A Position Paper' University of Michigan. (2003).

⁶⁷ See also . E.Edmonds and N. Pavenik, 'Does Globalization Increase Child Labor? Evidence from Viet Nam,' NBER Working Paper Series, pp. 1-11 and 31/32 www.nber.org/papers/w8760; and Neil McCulloch, L Alan Winters and Xavier Cirera Trade Liberalization and Poverty: A Handbook. CEPR

⁶⁸ Martin, W, Maskus , KE. *Op cit*.

⁶⁹ Corden, M. and Vousden, N. 'Paved With Good Intentions: Social Dumping And Raising Labour Standards In Developing Countries', in Zdenek Drabek (ed.) *Globalisation under Threat*. <http://www.economics.unimelb.edu.au/SITE/mcorden/pavedwithgoodintentions.pdf>

2.6 Administrative issues

Any accurate estimate of the financial implications of a QMA scheme will firstly depend on the particular mechanism chosen. For example, a QMA scheme that is applied at a national level (like GSP+) would only require products to carry a certificate of origin. The costs of this will depend on the complexity of the Rules of Origin being applied. An alternative and more likely approach is to create of a QMA system along the lines of Eurepgap, which requires individual producers to certify their products methods.

There are both ‘indirect’ and ‘direct’ costs involved in setting up a producer based QMA scheme. The indirect ‘costs of certifiability’ include the resources needed to initially achieve the necessary assessment criteria for the scheme and the management and information systems needed for verification and the so-called ‘chain of custody.’⁷⁰ Direct costs are those paid to the certifying body to cover the costs of the certification operation itself, such as establishing the institutional framework of accreditation and certification, defining criteria and indicators, or developing human resources and administrative procedures. Both the direct and indirect costs will be highly dependent on local implementing conditions.

This can be seen in the following table setting out the costs of complying with Eurepgap in three different African countries. Here the most notable cost differences are in the macro set up costs in Mozambique and Tanzania, and the micro set up costs in Guinea and Tanzania. The on-going micro costs do not appear to that different.

In the area of forest management, for example, the following costs have been identified:⁷¹

Indirect costs:

- 1) Incremental costs of forestry management to meet certification criteria
 - a) Investment costs
 - b) Silviculture
 - c) Harvesting
 - d) Other management costs
 - conservation areas / lower yields
- 2) Information – costs of certification
 - a) Forest management
 - Resource inventories and surveys (timber, biodiversity, soil, waste etc)

⁷⁰ The chain of custody has been defined as ‘an unbroken trail of accountability that ensures the physical security of samples, data and records.’ see <http://www.thecarlsoncompany.net/cc.html>

⁷¹ Viana, Virgílio M., Richard Donovan, Jamison Ervin, Henry Gholz, Chris Elliott (1996) Certification of Forest Products: Issues and Perspectives.. Island Press.

- Socio-economic surveys
 - Forest management planning
 - Recording and reporting activities
 - Internal inspection costs
- b) Chain of custody
- Marking logs
 - Recording and reporting activities
 - Additional costs of transportation, storing, processing and distribution
 - Internal inspection costs

Direct costs:

- a) Application
- b) Auditing (initial)
- c) Annual auditing
- d) Fixed fees (royalties etc)

Conformity under QMA is a legal requirement, therefore certification must also be officially confirmed by either or both of EU public bodies in the exporter and the customs authorities of the EU. This creates other additional institutional and administrative costs. For example recent fieldwork research in Pakistan reported the following:

Despite not having substantial problems in meeting standards, they complaint that the paperwork needed to get the proper certifications is cumbersome. Export certificates are issued by the respective Chamber of Commerce but they have to be certified by the respective embassy. This process seems to be costly and problematic.⁷²

The study of the implementation of the EUREPGAP standards in Morocco indicated that production costs increased by 8 percent for an efficient farmer. At the farm level 8 percent amounts to about 3 percent of the cost of the whole supply chain of an integrated exporter. Compliance with standards clearly can benefit large-scale companies over their small scale competitors. The case study also noted that farmers had most difficulty complying with pesticide standards because of lack of availability on the Moroccan market. The national system for pesticide registration is slow in registering new pesticides and for some products, the combination of MRL regulations and Moroccan pesticide regulations prevents both producers and traders from entering some export markets. The St. Vincent submission to the WTO also noted that in the Windward Islands the external auditors consider treated sleeves used in the banana industry as a pesticide and therefore require that these be stored under specific conditions. However, in the Dominican Republic sleeves are not considered to be pesticides and therefore there are no

⁷² Sussex researcher's fieldwork report for DG Trade.

specific requirements for storage, which creates additional difficulties in meeting requirements.⁷³

In the Agadir region of Morocco, a medium-sized tomato farm of 10 hectares estimated the cost of implementing a EUREPGAP standard to be US\$51,000 for direct set-up costs (for example buildings and equipment). Indirect costs recurring annually include training, monitoring, surveillance and certification were estimated to be 8 percent of the total accumulated farm gate costs. After post-harvest, transport, and marketing costs are added, compliance costs represent 3 percent of the total cost.⁷⁴

QMA requirements necessarily add significantly to both the production costs and the transactions costs of shipments. It is clear that not only would the true costs and resource implications depend on the form of the scheme, but more significantly on the conditions of the country and the local production site where they are being implemented.

2.7 Conclusion on the evidence

In 2001 a study for the UK government concluded:

*'In summary, the evidence suggests that, in general, higher SHE [Social, Health and Environmental] standards tend not to detract from economic growth and competitiveness and may have a beneficial effect. Likewise, there is little evidence that governments have been inhibited from raising SHE standards by the possibility of higher standards having a negative effect.'*⁷⁵

We find this convincing.

⁷³ Communication from Saint Vincent and the Grenadines to the WTO on Private Industry Standards. G/SPS/GEN/766. 28 February 2007.

⁷⁴ Omar Aloui and Lahcen Kenny. [The Cost of Compliance with SPS Standards for Moroccan Exports.](http://www.siteresources.worldbank.org/INTRANETTRADE/Resources/Topics/Standards/MoroccoCountrySurveyF.pdf) <http://www.siteresources.worldbank.org/INTRANETTRADE/Resources/Topics/Standards/MoroccoCountrySurveyF.pdf>

⁷⁵ Rights of Exchange' archive.cabinetoffice.gov.uk/servicefirst/2001/taskforce/gettingittogether/foreword.htm

Chapter 3. The Legal Analysis

Introduction

A general approach to QMA measures considers the range of possible ‘trade filters’ to qualify acceptable products (or to disqualify unacceptable products). As noted in the introduction to the report, the QMA proposals have a distinct feature in common in that they are all seeking to qualify food and agriculture products on the basis of their production methods, *i.e.*, values that are associated with ‘how’ they are produced rather than with considerations that are reflected in the characteristics of the final products. This aspect has been identified throughout this study by the term ‘non-product related production process methods’ - or NPR PPM for short.

From a GATT trade law perspective the range of potential NPR PPM measures falls into distinct categories which lead the legal analysis. In short, measures that affect trade either operate at the border ‘upon importation’ or ‘behind the border’ as domestic regulatory acts. In addition measures are also grouped as either fiscal or non-tariff instruments. Both of these types can also apply either upon importation or operate behind the border. Fiscal measures include import tariff duties or internal taxes such as excise or sales taxes. Non-tariff measures, (quantitative measures as some would say) include quantitative restrictions in form of quotas or prohibitions that operate at the point of importation, and a wide variety of internal regulatory requirements including product and food safety standards that govern the marketability of products. The dividing lines between these categories, particularly quantitative measures on importation as compared to domestic regulations with a quantitative effect, are not always so easy to identify in any given case. Nevertheless GATT law applies different rules based on these characterisations.

What this legal study intends to do is to take up the QMA measures (fiscal and non-fiscal) across these different legal ‘boxes’ and determine where GATT law might have some potential to validate a NPR PPM measure. At the same time, there is a bit of directed emphasis on the use of fiscal measures. As noted in Chapter 1.4 above:

This proposal differs from most of the alternatives in that it seeks to raise MFN tariffs about applied or even bound rates, and involves payment of financial compensation, but only equivalent to revenue raised.

Since this type of measure is explicit in QMA it is isolated accordingly for treatment in section one by GATT Articles I and II. From there, the analysis proceeds to deal with internal treatment (as national treatment) in GATT Article III. For all of these GATT Articles, general exceptions are available according to GATT Article XX, and this is taken up in section three. Following this treatment of general GATT Articles, section four considers other WTO Annex IA agreements that deal with product and food safety standards as governed by the SPS and TBT Agreements. This leads to a consideration of voluntary guidelines and private standards provided in section six. The final sections deals with the role of international agreements as they relate to the trading rules covered throughout. Section seven provides some conclusions.

3.1 Tariff Duties and Most Favoured Nation

This section looks at altering import tariff duties among physically identical products on the basis of NPR PPMs. The QMA proposal calls for raising tariff levels on agricultural products. This tariff increase can be made effective in either of two ways. First, a new tariff rate can be charged that is in excess of the existing scheduled tariff binding. This would likely be the case where the EC is already charging the conventional (negotiated) bound tariff duty rate. The second case, discussed further below, is where the EC is currently charging an applied rate on qualified products that is below its negotiated binding. This presents an option that would be more defensible from a WTO legal view. For EC agriculture products however, it appears that there are not many tariff lines that have sufficient ‘binding overhang’ to support this strategy for a QMA arrangement.⁷⁶

3.1.1 Charges in excess of the binding

Both of these possibilities raise the problem of differentiating among ‘like’ products but putting this common aspect aside just for now, the first choice above is immediately problematic in GATT law. Any charge that is higher than the negotiated scheduled rate will trigger a GATT Article II violation, as follows:

Article II: Schedules of Concessions

1. (a) Each contracting party shall accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.

Here WTO Members agree to not charge a tariff duty higher than their negotiated scheduled rate. Imposing a higher tariff is an obvious violation of the GATT rules. The GATT Agreement however also provides a possibility for adjusting bound tariff rates through the process of negotiation and agreement, which contemplates provisions for

... ‘compensatory adjustment with respect to other products’ and the attempt to maintain the ‘general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in the Agreement prior to such negotiations.’ (GATT Article XXVIII:2)

This adjustment would normally be made by the process of lowering tariffs on other products to adjust the compensation that is owed to the detrimentally affected members. For Members that have a diverse trade this rebalancing can be accomplished. For countries that trade in few products, or do not trade in volumes adequate to offset the tariff increase, this compensation is not easily accommodated.

⁷⁶ One study indicates that 5.6 percentage of EC agriculture products have a binding overhang between 15 and 50 percent, with .6 of the products having an overhang of over 50 percent. See Bchir, M., Jean, S., La Borde, D., (2005), ‘Binding Overhang and Tariff-cutting Formulas’, CEPII, table 3.

In that case, the option left to the affected exporting country is to ‘withdraw equivalent concessions’ on products of origin to the European Union. This type of suspension can operate as a ‘penalty’ both upon (unrelated) EU producers who lose market access, but also to the detriment of consumers and producers in the country retaliating.

The legal certainty of either compensation or retaliation raises the question of how any QMA funding mechanism would function as a ‘redistribution’ of the higher tariff duties imposed by the EC. For instance, the EC may collect a higher tariff duty on these products, but its obligations to compensate the export members for their loss of trade is going to happen irrespective of whether the EC arranges a developmentally-oriented funding mechanism. This is to suggest for this aspect of the QMA proposal that the EC will ‘pay’ twice for raising its tariffs, once as according to GATT rules, and second as according to the proposed QMA funding arrangements.

3.1.2 Tariff differentiation below the binding

The second type of adjustment mentioned above deals with varying tariff rates ‘below the binding’. Here there are more possibilities within the GATT law in those product examples where the EC is charging an applied rate below the binding level. A WTO Member can always charge an applied import duty rate below the binding level and then alter that rate up or down without violating Article II: 1(a) of the GATT.

However, and as common to many of aspects of this topic, the question is whether (or how) a member can accord different treatment on physically identical products, and in respect of the most-favoured nation obligation of GATT Article I, whether this member risks according more favourable treatment to some members than it accords to others?

3.1.3 Differentiation and sub-classification

For import tariffs and the purpose of tariff negotiations, WTO Members are allowed a large discretion to sub-categorize and create fine differentials among very similar competitive products. For purposes of Article I of the GATT (MFN) it is sometimes argued that products can be successfully differentiated in a manner that would not be permitted under GATT Article III, which prohibits discrimination against imported products that are in a close competitive relationship with domestic products, in other words, that the notion of “like products” in Article I:1 of the GATT is narrower than that notion in Article III:4. The GATT policy objectives and context governing tariff differentiation is different than those governing internal national treatment. Tariffs are a legitimate means of providing for economic protection for domestic producers and countries are permitted a wide scope to differentiate products for applying different tariff rates. The following two paragraphs from *Japan – Dimension Lumber* spell out the ground rules for differentiation and sub-classification.

5.9 The Panel was of the opinion that, under these conditions, a tariff classification going beyond the Harmonized System's structure is a legitimate means of adapting the tariff scheme to each contracting party's trade policy interests, comprising both its protection needs and its requirements for the purposes of tariff - and trade negotiations. (...)

5.10 Tariff differentiation being basically a legitimate means of trade policy, a contracting party which claims to be prejudiced by such practice bears the burden of establishing that such tariff arrangement has been diverted from its normal purpose so as to become a means of discrimination in international trade. (...)⁷⁷

The classic example of finely tuning product distinctions for the purpose of a tariff duty is drawn from the 1904 Swiss-German treaty reducing tariffs on, '... large dapple mountain cattle reared at a spot 300 meters above sea level and having at least on month grazing each year at a spot at least 800 meters above sea level.' As Hudec pointed out, almost any characteristic differences can be established and justified in a tariff negotiation, with the violating line being those more blatant characterizations, like the German cattle tariff, that '... will be objected to when it is closer to an explicit distinction between countries than it is to a distinction between products according to their objective characteristics.'⁷⁸

In principle, narrow classifications are permitted for protectionist interests, discrimination by country of origin is practiced when it is not overtly blatant, and the burden of establishing that a tariff differentiation has been diverted to a discriminatory purpose rests with the party challenging the classification.

3.1.4 Differentiation on the basis of NPR PPM

The question presented here is whether this capacity for fine distinctions among products can be extended to those generated by production process differences that are not based on physical characteristic or even end-use distinctions. We do not have 'like product' cases from the Appellate Body on GATT Article I tariff treatment. However, the 'factors' that are used to assess likeness are available from the AB Article III cases – even while the so-called 'accordion of likeness' is arguably different (far more narrowly squeezed) for Article I and tariff differentiation. When we consider the factors available, it is clear that the consideration of 'consumer tastes and habits' would be the primary one considered to differentiate otherwise identical products.

⁷⁷ *Japan – SPF - Dimension Lumber* (L/6470 - 36S/167).

⁷⁸ Hudec, R., (2000), 'Like Product': The Differences in Meaning in GATT Articles I and III, in Cottier & Mavroidis (eds.), *Regulatory Barriers And The Principle Of Non-Discrimination In World Trade Law*, University of Michigan Press, pp. 101-123. The cattle example can also be cited for the use of a process standard in a tariff description. Another example a PPM-based tariff might be different applied rates for 'handcrafted' products.

We do not have a case that has taken up ‘consumer tastes and habits’ as the single distinguishing factor. What we do know is that a WTO panel is called upon to examine each and every relevant factor and to assess its role (its weight) in validating the distinction. We also know that neither Article I nor Article II of the GATT *exclude* the use of consumer tastes and habits as a sole differentiating factor. We also suggest that consumer tastes and habits can be given legitimate expression through national legislative enactments, and this aspect would tend to validate a distinction made on this basis. In addition, the criterion for assessing like products also includes ‘any other relevant factor’ that may be identified. If the domestic ‘consumer tastes and habits’ expression was also supported by an identifiable international obligation or declaration which the EC had adopted, then this additional factor may also be available to argue the value of the distinction before a panel. While a traditional majority of academic opinion probably maintains that NPR PPMs are not GATT lawful, this issue has not been explicitly ruled upon since the establishment of the WTO. For production-based distinctions, the shift in context to Article I tariff duty considerations (as contrasted with GATT Article III for national treatment) may also be noteworthy. The concept of product ‘likeness’ is not the same when considering legal tariff protectionism as compared to the broader context of ‘competitive relations’ among similar products applied for the national treatment test. While we do not really know if the consumer taste and habit factor is sufficient to successfully distinguish products for national treatment, the GATT Article I context will not pose any greater difficulties for the distinction to be drawn on this basis, and it may pose less difficulty where Members are given more latitude to sub-categorize their tariff structures.

3.1.5 The ‘unconditionality’ requirement

While the product likeness scope may vary between GATT Articles I and III, there is an additional obligation that is found only in Article I. This is the requirement that,

‘... any advantage ... granted to any product ... shall be accorded immediately and unconditionally to the like product originating in ... the territories of all other contracting parties.’

This means that irrespective of the like-product question for Article I MFN, that this article imposes a separate requirement that tariff advantages may not be made subject to ‘conditions’. For a QMA arrangement granting better (or worse) tariff duty treatment on the basis of other country characteristics or legal regimes, this ‘unconditionality’ requirement would also provide a basis for a WTO legal challenge.

For this requirement there remains a difference of opinion (and WTO panel reports) on whether the requirement only applies when the condition imposed is based upon a ‘country difference’ (origin-based), or whether any condition placed upon producers of products (non-origin based) will also violate the obligation. An origin-based distinction would raise a ‘red flag’ that the treatment was being offered subject to a condition. A non-origin based

treatment that would accommodate individual products irrespective of their country of origin and would at least provide an argument that the requirement was not being violated.

3.1.6 Denial of reasonable expectations

Sub-categorization is common in tariff schedules and this means that schedules are not static, but rather dynamic. Since Members ‘change’ their schedules, the question arises whether a Member’s otherwise lawful sub-categorization may undermine another member’s reasonable expectations that the classifications would have remained the same and not be altered in a manner to detrimentally affect its trade position. This concept of ‘reasonable expectations’ raises aspects for both GATT Article II provisions and for so-called ‘non violation’ theories of nullification and impairment in the GATT. Where characterization differences are established prior to tariff negotiations, then the reasonable expectations of all Members are understood and the process of negotiating on the new classifications will tend to validate the distinctions. Here, the situation is more complex where tariff classifications on agriculture products are already established in previous negotiation rounds and then asking what ‘right’ of reasonable expectations do other Members have thereafter to rely upon that earlier structure. On this the cases are not clearly on point.⁷⁹ The right of reasonable expectations is clearly not unlimited otherwise members could never subcategorize or alter their characterizations. As Jackson stated in reviewing an older GATT working group determination dealing with the ‘new product’ of long playing phonograms, there is also little clear precedent established in the practice. However, there did appear to be a consensus at that time that a new product fell within the existing binding where the description clearly covered it and no reservation had been made in the earlier descriptive heading. In addition, reference can be made to national law to determine the principle of classification being used, but this is not a controlling factor.⁸⁰ As noted above for tariff increases ‘below the binding’, a similar consideration may be offered here. Reasonable expectations may be less offended where the new sub-classification is not a tariff increase but rather a tariff decrease. Members qualifying under the older tariff are relatively affected but not presented with an absolute increase. This appears to reinforce the point that absolute tariff increases in a QMA arrangement will raise challenges of WTO legality by other Members.

3.1.7 Section summary

We have considered some legal aspects for sub-categorizing an agriculture product based upon its NPR PPM characteristics by the use of import duty charges that are altered either above or below the binding. For charges made going above the binding, a distinct line of

⁷⁹ The 1952 *German – Sardines* case involved an historical agreement between the parties to not grant less favourable treatment. The much later *EC- Computer Equipment* case made an interpretation giving effect to the reasonable expectations of both parties, but in a fact situation where there was a misunderstanding over which classification the products fell within.

⁸⁰ Jackson, J. *World Trade and the Law of GATT*, Lexis Publishing, 1969. p. 214.

attack for an affected exporter is the sanctity of the binding itself. Other theories of complaint discussed above apply in order to alterations made either above or below the binding level of the product concerned. For an allegation of discrimination among like products the classifications should be configured so as to not share that characteristic of being blatantly discriminatory on the basis of country origin. Any scheme that requires complete country certification (as contrasted to producer certification) is more likely to be found to be *de jure* discriminatory. This is a similar consideration for GATT Article I's requirement to not impose conditions on the receipt of a tariff advantage whereby any imposed condition that applies (in law or in practice) to countries as a whole is more likely to trigger a finding of a violation. Finally, where tariff schedules are being altered, negatively affected exporters may try to plead that their reasonable expectations have been undermined by the reformulation.

Any violation of a GATT provision can be defended by a reference to GATT's General Exceptions as found in Article XX. A consideration of these exceptions will be made following a discussion of the QMA proposals as they may be presented as internal tax or regulatory instruments. These would be treated according to GATT Article III for National Treatment.

3.2 Domestic Regulation

Introduction:

This section examines whether domestic NPR PPM schemes, such as the proposed taxation-based qualified market access (QMA) scheme, could be consistent with GATT Article III national treatment. For the purposes of this analysis, we assume that the QMA scheme and its measures will be origin neutral, focusing on ‘bad’ products or firms rather than countries. This assumption allows for an assessment of the legality of QMA schemes beyond a narrow discussion of a *prima facie* violation of the non-discrimination requirement according to GATT Article III. The discussion in Section 4 then focuses on whether an origin neutral QMA scheme having failed the Article III requirements, can then subsequently be justified under the General Exceptions of GATT Article XX.

The legality of an origin neutral NPR PPM taxation requirement, such as the QMA scheme, within the GATT/WTO system is not unambiguous. There are two broad schools of thought on their legality within the WTO. On the one hand Howse and Regan⁸¹ argue that a contested NPR PPM analysis should first be assessed under Article III. From this perspective Article III does not prohibit PPMs per se, only protectionist PPM-based measures. Gaines, in contrast, argues that measures using NPR PPMs to distinguish between physically indistinguishable products, which such NPR PPM schemes are, violate Article III on the basis that these products are indistinguishable. Their permissibility would then have to be assessed under the GATT Article XX Exceptions.⁸²

We examine the application of GATT Article III paragraphs 2 and 4 with respect to both a taxation based and a non-taxation based QMA scheme such as the Kimberley Process Certification Scheme (KPCS). We conclude that the jurisprudence relating to Article III does not unequivocally permit nor outlaw NPR PPM measures such as those included in the proposed QMA scheme. Prevailing interpretations of ‘like products’ under this Article do not recognise NPR PPMs as features capable of distinguishing products from each other. Nevertheless, because the proposed QMA measure may also accord to the ‘group’ of like imported products no ‘less favourable treatment’ than it accords to the ‘group’ of like domestic products - there is a possibility that if the ‘good’ and ‘bad’ products are taken together within a single group of like products, then the QMA measure will not be seen to violate GATT Article III on national treatment. However, it is our opinion on balance that it is more probable that an NPR PPM QMA scheme, whether taxation based or not, would not pass the Article III tests and ultimately would need to be defended under GATT’s Article XX exceptions.

⁸¹ Howse R, & Regan, D, The Product/Process Distinction – An Illusory Basis for Disciplining Unilateralism' in Trade Policy, 11 EJIL 249 (2000).

⁸² Gaines, S. (2002) ‘Processes and Production Methods: How to produce sound policy for environmental PPM-based trade measures?’ Columbia Journal of Environmental Law. Vol 27, p383.

3.2.1 Article III and discrimination on the basis of NPR PPMs

Article III governs domestic taxation and other internal regulatory measures, which a government sponsored QMA scheme would fall under. This article obligates WTO Members to grant foreign products treatment that is ‘as least as favourable’ as the treatment granted to domestic or national ‘like products.’ Paragraph 2 of Article III covers domestic taxation policies, such as the measure set out in the proposed QMA scheme. The first sentence of this paragraph prohibits Members from taxing ‘like’ imported products in excess of ‘like’ domestic products. The second sentence states that Members will be in violation of their obligations if, under their tax regimes, ‘directly competitive or substitutable’ imported and domestic products are ‘not similarly taxed’ and then applied ‘so as to afford protection.’

The obvious legal challenge to be made in defending such a QMA measure is the ambiguity arising from the absence of definitional criteria within the provisions of Article III for distinguishing between traded products based on differences that are not physically embodied in a product. Such criteria is generally absent in the GATT/WTO with the obvious exception of the use of prison labour, set out in GATT Article XX(e) and the provisions governing Subsidies and Countervailing Measures (SCM) which explicitly provides a definition of ‘likeness.’ Consequently, Article III jurisprudence on ‘likeness’ has thus been conducted on a case-by-case basis, involving an ‘unavoidable element of individual, discretionary judgment.’⁸³

Article III:2 has two categories of comparable products. Firstly it requires Members to ensure that ‘like’ imported products are not taxed at all ‘in excess’⁸⁴ of ‘like’ domestic products. Here the Appellate Body interpreted ‘in excess of’ strictly, stating that it is irrelevant whether the different levels of taxation are merely *de minimis*. That is, any level of taxation imposed on imported products that exceeds the level imposed on domestic ‘like’ products will be deemed inconsistent with the first sentence of Article III:2.⁸⁵ Secondly, but of equal importance,⁸⁶ under Article III:2 if Members do not subject ‘directly competitive or substitutable products’ to similar levels of taxation, there must be an assessment to determine whether the different rates of taxation are applied ‘so as to afford protection to domestic production’. While the scope of ‘directly competitive or substitutable products’ is broad, it is governed by the overall anti-protectionist thrust of Article III:I through an examination of whether or not the measures is applied ‘so as to afford protection’.

⁸³ Japan–Alcoholic Beverages Appellate Body Report. Section H.1.a. (1996).

⁸⁴ The Japan – Alcoholic Beverages Appellate Body found that any level of taxation imposed on imported products that exceeds the level imposed on domestic ‘like’ products will likely be deemed inconsistent with the first sentence of Article III:2. Op cit. (Section H.1.b).

⁸⁵ *Ibid.*

⁸⁶ *Ibid.* The Appellate Body clarified that the phrase ‘like products’ in Article III:2 must be interpreted narrowly so as to not overshadow Article III:2’s second, broader category of ‘directly competitive or substitutable products.’

As a taxation scheme, the QMA measure would not fall under Article III:4, which applies to other, non-tax laws and regulations. A QMA scheme that required firms producing socially ‘bad’ products to inform consumers of their ‘unacceptable’ production methods would be considered under this paragraph. The Kimberly Process Certification Scheme (KPCS) for example, requires that a certificate accompanies all rough diamonds to ensure that they are not ‘conflict’ diamonds, used as a source of finance by rebel forces to undermine governments. Article III:4 requires Members to ensure that non-tax internal regulatory measures afford imported products treatment that is ‘no less favourable’ than that offered to ‘like’ domestic products. Article III:4 solely refers to ‘like products,’ nevertheless, the Appellate Body in *EC – Asbestos* stated that to give effect to the purpose of Article III, the combined product scope of Article III:2’s two product categories should not differ significantly from the scope Article III:4’s ‘like products’ category.

If, under a non-taxation QMA measure products are found to be ‘like’ under Article III:4, the WTO tribunals will next examine whether the imported products are afforded treatment ‘less favourable’ than their domestic counterparts. The examination will find that under such a scheme there is origin-based discrimination if the different requirements afforded to these ‘bad’ and ‘good’ products result in a bigger overall disadvantage to the group of like (‘good’ and ‘bad’) imports as compared to the group of like (‘good’ and ‘bad’) domestic products. The Appellate Body in *Korea – Beef* stated that countries’ regulations may formally discriminate between imported and domestic products as long as those regulations do not modify the conditions of competition in the relevant market to the disadvantage of the imported product. A QMA scheme necessarily modifies the competitive environment among products that are in a close competitive relationship, but the question is whether this also results in a competitive disadvantage for (‘good’ and ‘bad’) imports compared to the group of like (‘good’ and ‘bad’) domestic products.

Clearly, if under Article III ‘likeness’ were to be interpreted so as to consider environmentally or socially harmful products as ‘unlike’ similar but environmentally or socially ‘good’ products, the WTO’s non-discrimination provisions offer considerable flexibility for Members wishing to enact a QMA scheme, whether taxation based or not. The difficulty with this interpretation is that precise boundaries of ‘likeness’ and the impact of a ‘likeness’ determination on domestic policy making are still unclear within both the text of Article III provisions and GATT/WTO jurisprudence. What is relevant for discussions on ‘likeness’ is the *Border Tax* Working Party criteria for determining ‘like products’ as set out in a 1970 GATT working group report. These include the product’s end-uses in a given market; consumers’ tastes and habits, which change from country to country; the product’s tariff classification; and the product’s properties, nature and quality.⁸⁷

⁸⁷ The Border Tax Adjustments Report of the Working Party, adopted on 2 December 1970. (L/3464). Paragraph 18 reads: 18. With regard to the interpretation of the term ‘... like or similar products ...’, which occurs some sixteen times throughout the General Agreement, it was recalled that considerable discussion had taken place in the past, both in GATT and in other bodies, but that no further improvement of the term had been achieved. The Working Party concluded that problems arising from the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a ‘similar’ product. Some criteria were suggested for determining, on a

In the 1987 *Japan-Alcoholic Beverages* dispute, the panel examined the criterion of consumers' tastes and habits, and concluded that such an analysis could be misleading because of the potential for differential taxes to crystallize consumer preferences for domestic products. The panel then found that 'directly competitive or substitutable products were those with common characteristics, and which consumers seemed to view or use as alternatives or substitutes for others. Some products which the panel did not conclude were 'like' were nevertheless found to be 'directly competitive or substitutable'. The 2001 *EC – Asbestos* Appellate Body report further concluded that Panels must look at *all evidence* relevant to a 'likeness' determination, assessing *each* criterion separately, and then weighing *all* relevant evidence together when concluding whether or not the different products examined are 'like products'.⁸⁸ In cases where the products are '....physically very different, a panel can still conclude that they are 'like products' if it examines the evidence relating to *all* four criteria in analyzing 'likeness': (i) the properties, nature and quality of the products; (ii) the end uses of the products; (iii) consumers' tastes and habits, which is also known as consumers' perceptions and behaviour towards the products; and (iv) the tariff classification of the products.

In defending a QMA measure that differentiates between desirably and non-desirably produced goods, it is criterion (iii) consumers' tastes and habits that offers the most potential for justifying a differential taxation policy on the basis of the products being "unlike". This is because of the Appellate Body's reliance on the nature of the 'competitive relationship' between two products in determining product likeness, and on 'consumer tastes and habits' in determining product distinctiveness in the *EC - Asbestos* dispute. A QMA scheme may be considered as consistent with Article III based upon the evidence that the PPMs in question have well established markets and/or well established health or environmental risks which shape consumer behaviour. As Potts has argued, PPMs drawn from existing eco-labelling systems and other voluntary standards systems which have demonstrable market-shares provide an obvious inroad into the design of a PPM policy which is legitimized by the natural market recognition of PPM-based product distinctiveness.⁸⁹ However, consumer tastes and habits is but one of the four criteria to be considered. A QMA scheme, whether taxation based or not, would be found to differentiate between like products under the other three criteria since for each of those factors there are no differences between the products being compared.

We argue that if contested, the proposed taxation based QMA scheme would initially be considered under Article III:2. At present it is most likely that products produced in an environmentally or socially preferable manner will be considered to be 'like' those produced in what is perceived to be an undesirable production manner. However, if under

case-by-case basis, whether a product is 'similar': the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality. It was observed, however, that the term '... like or similar products ...' caused some uncertainty and that it would be desirable to improve on it; however, no improved term was arrived at.

⁸⁸ *EC – Asbestos AB report*, WT/DS135/AB/R, paragraphs 101–103.

⁸⁹ Potts, J., (2008), *The Legality of PPMs under the GATT*, International Institute for Sustainable Development.

Article III, differently treated products have been found to be ‘like’, there are two different paradigmatic approaches to identify less favourable treatment. Firstly a ‘diagonal’ approach sometimes advocated compares the treatment accorded to the ‘bad’ imported product with that of the ‘good’ product. Under a QMA measure for example, non-child labour produced carpets receives more favourable treatment than carpets produced by unregulated child labour. Such a methodology will inevitably result in an Article III:4 violation if the ‘bad’ product is (potentially) imported and the ‘good’ product exists domestically.

A second more correct approach of comparing ‘like’ product treatment was suggested by the Appellate Body report in the *EC-Asbestos* case. Here Canada challenged the differential treatment by France of two allegedly similar products: asbestos or chrysotile fibre was banned, while substitute PVA, cellulose or glass fibres were permitted. Canada claimed that the French ban on asbestos altered the competitive environment conditions between Canadian asbestos products and French substitute fibre products. The Appellate Body Report suggested an alternative methodology to the diagonal approach by comparing the treatment of a ‘group’ of imported products with a ‘group’ of domestic products. It has been argued that applying an aggregate comparison is logical because ‘a distinction between like products does not necessarily result in less favourable treatment of the entire group of imports, although *some* like imported products (necessarily) do receive worse treatment than *some* like domestic goods.’⁹⁰

It is our opinion that if the ‘aggregate’ or group approach is applied, it is possible that a formally original neutral QMA measure would not violate the obligations of Article III as long as the measure does not impose a heavier burden on the group of imported like products. If the QMA measures in question are found to discriminate against imports, such schemes would have to be justified under one or more of the Exceptions of GATT Article XX.

3.3 GATT Article XX Exceptions

Introduction

The exceptions of Article XX are the main provisions in the GATT that aim to balance conflicts that arise between the GATT’s free trade objectives and other listed legitimate domestic non-trade policy goals. If a WTO Member’s domestic regulatory measure is found to violate the non-discrimination obligations of the GATT, a Member may still defend the measure under the provisions of Article XX. As the following sections discuss, the most relevant exceptions of Article XX for the proposed QMA scheme are set out in these following paragraphs:

⁹⁰ Ehring, L. ‘De Facto Discrimination in WTO Law: National Treatment and Most-Favoured-Nation Treatment—or Equal Treatment?’, Jean Monnet Working Paper (NYU School of Law, 2002) and 36 *Journal of World Trade* (2002) 921-977.

- (a) necessary to protect public morals.
- (b) necessary to protect human, animal, or plant life or health;
- (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices;
- (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

Measures that can satisfy the requirements of one or more of the subparagraphs of the exceptions are subsequently examined for their consistency with the Chapeau of Article XX. This Chapeau is designed to ensure that a contested measure is ‘not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination’ or a ‘disguised restriction on international trade.’ Whether or not a QMA measure conforms to the Chapeau would depend on whether or not the measure subjected the designated ‘bad’ product to the same penalty import tax regardless of its country origin. i.e., origin neutral non-discrimination. If the scheme applied only to developing country Members, for example, it would violate the requirements of the chapeau.

Although the Article XX exceptions are seen to balance the obligations of Members with the right to implement legitimate domestic measures relating to the environment or social welfare, these provisions may not be sufficient to justify the proposed NPR PPM QMA scheme. Further, under Article XX the burden of proof is shifted from the complainant onto the respondent (the implementer of the QMA scheme) and the respondent must prove the ‘necessity’ of the measure within the framework of the provisions governing the individual exceptions.

It is our opinion that a QMA scheme could potentially satisfy the requirements of these Article XX exceptions under certain conditions. Firstly, the scheme must be origin neutral, focusing instead on ‘unacceptable’ products or firms. It is also likely that the scheme will be perceived to be more legitimate if the policy objectives are based on internationally determined standards rather than domestic preferences. As discussed below, these provisions demand that further conditions are required to be legitimate, such as that the measures used in the QMA scheme are both necessary and the least trade restrictive option reasonably available to attain these legitimate goals.

3.3.1 The validation of extra-territorial measures

A trade measure can be considered to be ‘extraterritorial’ when it either relates to practices that are beyond its own customs territory (regulation of practices on the high seas, for example), or when it seeks to compel another Member to comply with its own domestic requirements. The Article XX exceptions do not address the territorial application of national measures. That is, while Articles XX(a) and (b), for example, allow Members to take measures necessary to protect public morals or life and health, respectively, they do not say whether the application of this provision should be only within the jurisdiction of the WTO Member implementing the measure. And while Article XX(g) allows for the protection of exhaustible natural resources, it does not explicitly limit such protection to the territory enacting the measure. Article XX(e), in contrast, can only apply meaningfully to imports, i.e. to products made by prison labour abroad.

The issue of extraterritoriality has not been static in GATT / WTO jurisprudence. The *US-Shrimp* case reversed the earlier restrictive approach to ‘extra-territorial’ measures found in the unadopted GATT *US – Tuna/Dolphin I* Panel.⁹¹ The *US- Shrimp* panel explicitly stated that no measure of this type could ever be validated under the Chapeau of Article XX.⁹² On appeal, the Appellate Body found, however, that all measures seeking validation under Article XX had to first be considered according to the terms of the individual exceptions provided for in that Article, and then continued as follows:

In the present case, the Panel found that the United States measure at stake fell within that class of excluded measures because Section 609 conditions access to the domestic shrimp market of the United States on the adoption by exporting countries of certain conservation policies prescribed by the United States. It appears to us, however, that conditioning access to a Member's domestic market on whether exporting Members comply with, or adopt, a policy or policies unilaterally prescribed by the importing Member may, to some degree, be a common aspect of measures falling within the scope of one or another of the exceptions (a) to (j) of Article XX. (...) It is not necessary to assume that requiring from exporting countries compliance with, or adoption of, certain policies (although covered in principle by one or another of the exceptions) prescribed by the importing country, renders a measure *a priori* incapable of justification under Article XX.⁹³

It is our opinion that an NPR PPM QMA measure imposing ‘extra-territorial’ requirements is potentially capable of receiving validation under the GATT exceptions set out under Article XX. The exceptional categories that appear to relate most closely to a QMA regime’s environmental and social objectives include those necessary to protect public morals, health, life or the environment. For all of the exceptions under Article XX, a defence will be more convincing, and more successful, if the standards they aim to uphold are internationally recognised, such as the KPCS or fundamental ILO labour rights.

⁹¹ US – Tuna/Dolphin I Panel report concerning the US law prohibiting the import of tuna caught by dolphin-unfriendly methods. The US NPR PPM measure on the grounds that to rule otherwise would allow any Member to unilaterally determine the life, health and conservation policies of other parties, which would jeopardize the trading rights guaranteed by the GATT. paras 5.27, 5.32.

⁹² *US – Shrimp* Panel Report, WT/DS58/R para. 7.45.

⁹³ US – Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, para. 121.

Unilateral trade measures seeking to implement domestically determined standards of behaviour may be more difficult to defend if contested.

3.3.2 Article XX(a) of the GATT

(a) necessary to protect public morals.

Article XX(a) states that nothing in the GATT 1994 shall prevent the adoption or enforcement of any measure ‘necessary for the protection of public morals.’ Unilateral trade sanctions have been imposed in the past and although they have not been challenged, the exceptions of Article XX(a) of the GATT could have been invoked to defend these measures as ‘necessary to protect public morals.’ While this provision has not been interpreted by a Panel or Appellate Body, it is clear from Panel reports relating to the interpretation of other Article XX exceptions, that any QMA scheme would be expected to both aim to protect public morals and it must also be necessary to protect public morals.

While the GATT does not define ‘public morals’, the US- Gambling Panel Report stated that what constitutes public morals:

can vary in time and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values’ and that ‘Members should be given some scope to define and apply for themselves the concept[s] of ‘public morals’ [...] in their respective territories, according to their own systems and scales of values.’⁹⁴

The Panel in this case defined ‘public morals’ as being ‘standards of right and wrong conduct maintained by or on behalf of a community or nation’ and found the provision of on-line gambling services to be a risk to public morals in light of the history of US policies toward the domestic gambling industry

As such, the protection of public morals can be invoked as a ground for justifying a QMA scheme which discriminates against the sale and use of goods produced in a manner inconsistent with minimum labour standards, basic human rights, minimum animal welfare or accepted environmental standards. In *EC-Asbestos*, the panel developed an analysis requiring the party invoking an Article XX exception to demonstrate a nexus between the measure and its chosen policy objective by proving a connection between the targeted product and the risk posed by that product. Thus in order to justify a QMA scheme under Article XX(a), it must be shown that the measure falls under the specified general policy objective.

Then the measure must be deemed ‘necessary.’ This entails an evaluation of whether the measure is likely to achieve the stated policy objective and protect public morals from the ‘bad’ product in the first part of the analysis. The Asbestos Panel Report first looked at whether a risk exists before determining the level of risk, the portion of the population at risk from the product. The limits to what constitutes a risk to public morals under Article

⁹⁴ US – Gambling Panel Report, para. 6.462.

XX(a) is not definitive.. Article XX(a) was successfully invoked by Saudi Arabia in its Accession to the WTO to justify the ban on the importation of any alcoholic and all types of machines, equipment and tools for gambling or games of chance.⁹⁵ Whether this reasoning could also apply to a QMA measure depends on whether in the WTO Member state in question, ‘public morals’ or what is held to be right or wrong includes standards on the production processes in question themselves. The analysis will necessarily be country specific.

The Necessity Test

A contested QMA scheme defended under Article XX(a) that has been found to protect public morals, will also be examined under the ‘necessity’ requirement of that paragraph. In the 2001 *EC – Asbestos* Appellate Body Report, it was found that for a measure to be deemed ‘necessary’ it does not need to be ‘indispensable’ or ‘inevitable.’⁹⁶ Rather, a ‘necessary’ measure is situated somewhere between an ‘indispensable’ measure and a measure ‘making a contribution to’ a goal, albeit significantly closer to the pole of ‘indispensable’. The Appellate Body subsequently created the following three factor balancing test for deciding whether or not a measure is necessary when it is not per se indispensable.⁹⁷

1. The contribution made by the measure to the legitimate objective
2. The importance of the common interests or values protected
3. The impact of the measure on trade

Under this balancing test, the proposed QMA scheme could potentially be defended under (1) and (2) because it aims to prevent slave labour, for example, which is widely held to be socially unacceptable by the international community. However, given that the scheme most likely does significantly affect the competitive environment of those countries exporting goods produced using ‘undesirable’ slave labour production methods, it is open to being challenged under (3). The balancing process undertaken by a Panel needs to take account of all three factors, but given that the objective of a QMA measure is to restrict market access the Panel will have to find factors 1 and 2 compelling enough to justify the trade restrictive QMA measure. As noted by the AB in the *Brazil-Tyres* dispute, if the analysis yields a preliminary conclusion that the measure is necessary, the result ‘must be confirmed by comparing the measure with possible alternatives, which may be less trade restrictive while providing an equivalent contribution to the achievement of the objective. This comparison should be carried out in the light of the importance of the interests or values at stake. It is through this process that a panel determines whether a measure is necessary.’⁹⁸

⁹⁵ Report of the Working Party on the Accession of the Kingdom of Saudi Arabia to the World Trade Organization, WT/ACC/SAU/61, dated 1 November 2005, Annex F, List of Banned Products.

⁹⁶ Korea – Beef Appellate Body Report, para 161.

⁹⁷ EC – Asbestos Appellate Body Report, op cit, para 164.

⁹⁸ Korea-Beef Appellate Body Report, para 166, *Brazil-Measures Affecting Imports of Retreated Tyres*. WT/DS332/AB/R. 3 December 2007, para 187.

The Appellate Body report in *Korea – Beef* and *US – Gambling* noted that while the responding Member must defend a measure as necessary, it does not have to ‘show, in the first instance, that there are no reasonably available alternatives to achieve its objectives.’⁹⁹ A complainant Member may argue that there are alternative measures to a contested QMA scheme. For example, it could be argued that alternative GATT-consistent measures are available in the form of diplomatic persuasion and targeted development aid to increase the expertise and capacity of these countries to improve their production methods, or more plausibly for this discussion – the use of a product label indicating the ‘bad’ process used to make the product. In the *US – Shrimp/Turtle* dispute, the Appellate Body Report stated that the chapeau authorizes ‘an importing Member to condition market access on exporting Members putting in place regulatory programmes *comparable in effectiveness* to that of the importing Member’¹⁰⁰

It is our opinion that neither of these alternatives can be considered as ‘equally effective’. Given that the objective of the QMA scheme is to restrict market access, the use of mandatory labelling as a less trade restrictive alternative will necessarily not be equally effective. In the context of Article XX(a), only informing the public of child labour in the production process cannot be as effective to protect public morals as a restriction upon the access of those bad products to the market.

Therefore, it is also our opinion that a QMA type scheme could be successfully defended as necessary to protect public morals, particularly if a) the standards referenced in the scheme are internationally recognised; b) the Panel determine the impact on trade to be not disproportionate to the contribution made by the measure to achieving the legitimate objective; and c) the importance of the common interests or values being protected by the scheme is demonstrated.

3.3.3 Article XX(b) of the GATT

(b) necessary to protect human, animal, or plant life or health;

The overall objective of this paragraph is to safeguard a country’s ability to adopt measures that it deems are ‘necessary to protect human, plant, or animal life or health’. Relevant jurisprudence to date includes the 1990 GATT report from the *Thailand – Cigarettes* dispute and the 2001 *EC – Asbestos* Appellate Body Report. In the latter dispute, the Appellate Body dismissed the Canadian complaint against a health based French ban on asbestos in construction materials and instead upheld the French health measure as justified under Article XX(b) because it was found to be ‘necessary.’

⁹⁹ Brazil-Measures Affecting Imports of Retreated Tyres. WT/DS332/AB/R. 3 December 2007, para 165.

¹⁰⁰ US – Shrimp/Turtle Appellate Body Report, para 144.

As discussed above, the Panel would apply the three factor balancing test when determining whether or not a measure is necessary when it is not per se indispensable. It is our opinion that the discussion under Article XX(a) is relevant to Article XX(b). That is, the Panel would only find the proposed QMA scheme to be a legitimate exception to a Member's GATT obligations if the QMA scheme that could be justified in terms of its importance to the genuine public objective sought and was product or firm, rather than origin based.

3.3.4 Article XX(g) of the GATT

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

When considering the legality of the proposed QMA scheme within the framework of this provision, first the scheme must be assessed to see whether it qualifies as a 'measure.' The findings of the *US – Reformulated Gasoline* Appellate Body concluded that 'measures' should be conservation measures and not merely provisions or elements of overall measures found to violate the core GATT provisions.¹⁰¹ It is our opinion that given that the proposed QMA scheme can be viewed as a conservation measure in its entirety, it may be considered to be a measure.

Of additional relevance to the QMA scheme is that the term 'exhaustible natural resources' has been interpreted by the Appellate Body, to include living, renewable and non-renewable resources. This interpretation allows for a far broader range of environmental objectives within a QMA scheme. In *US – Shrimp/Turtle*, this paragraph was found to be applicable to resources that resided (at least in part) outside the territorial limits of the enacting party. How much more broadly this resource provision can be interpreted to cover the larger global environment has not as yet been tested. The meaning of 'relating to' was also defined as distinct from the term 'necessary' used in paragraph (b). In *US – Shrimp/Turtle*, the measure was tested to identify if 'relationship between the measure at stake and the legitimate policy of conserving exhaustible natural resources' is decisive.¹⁰² While vague, this arguably includes penalty import tax measures such as the proposed QMA scheme because in the case of environmental QMA schemes, the required relationship is decisive.

The proposed QMA scheme would be further examined under paragraph (g), to determine whether the same measures to which it subjects 'bad' imports are made effective in conjunction with restrictions on domestic production or consumption. This requirement is

¹⁰¹ US – Reformulated Gasoline Appellate Body Report, Section III.A.

¹⁰² US - Shrimp/Turtle, AB Report, para 135.

designed to prevent double standards in trade relations and would not prevent a QMA scheme as long as it required the same from its domestic production processes as from its imports.

It is our conclusion that a QMA scheme could be justified under Article XX(g) if there is strong evidence not only to support the sustainable development objectives of the measure, but also to indicate the linkage between existing domestic policy and the QMA scheme imposed on imports. This is in accordance with our conclusions under Article XX exceptions (a) and (b), and is based on the contention that the 3-factor balancing test must determine the importance of the objectives sought by the measure outweigh the impact on trade. The objective of the scheme is to restrict market access therefore the issue of the complaining Member identifying a less trade restrictive measure is not of relevance in this instance.

3.3.5 Product Labels and Certifications

Introduction

Product labels have been discussed in the Article XX context for their value as ‘other reasonably available alternatives’ to determine the necessity of a QMA measure. Here, we consider the use of conformity assessment certifications and product labels in their own right as a means to distinguish qualifying products on the basis of NPR PPMs. For summation, we consider that these devices can be used at two different points during the trading process. The first is where a certificate of conformity or a label is required to identify the product for the application of a border measure, either as possible restriction on the entry of the product or as a basis to assess a higher QMA tariff duty upon it. The tariff duty considerations were discussed in Section one. Those considerations continue to apply but here the focus is on the *means* used to actually make a formalized distinction between the products. For non-tax measures, to the extent that internal rules also require the same characteristics to be displayed on domestic products, then the national treatment rules discussed in section two above would be applied. Again however, the underlying *means* by which certificates or labels are composed and then applied by national authorities are subject to their own trading rules as governed by WTO Annex IA Agreements for product standards.

A second use of certifications and labels does not relate to the admission of products to the market, but to the purpose of informing the domestic consumer of the physical or production characteristics of the products in the market. Here we can see that labels can operate as ‘stand alone’ requirements allowing consumers to arguably express their ‘consumer tastes and habits’ in regard to NPR PPM distinctions. Although consumer-informing labels that do not restrict importation are not the focus of the QMA proposals as we understand them, they have been raised as possible alternative measures in the event that border restrictions or taxes are not legally viable. Thus, for this next section we consider the requirements that apply to this use of labels either as mandatory (government

compelled), or as non mandatory (private labelling schemes), and for both, as subject to a possible international standard-setting processes.

The question is raised whether labels can actually and meaningfully differentiate products. This has to be considered in light of the reasons differentiation is being sought. For customs differentiation, certification systems and their resulting certificates require a high degree of legal certainty, and in many cases, foreign conformity processes have to be assessed by national examiners. The resulting certification is considered reliable and the product can be differentiated. In an Article III case where there is a legal difference in treatment being made for otherwise identical goods, the Appellate Body has initiated some points for addressing consumer tastes and habits, as raised in section two above. We know that this answer can only be formed on a case by case basis, and in respect of the actual consumer market being examined. For systems that are not mandatory, the considerations may again be somewhat different. Here we tend to ask whether the consumer is being accurately informed of characteristics that matter to them and whether the system of conformity assessment leading to a qualifying label is 'legitimate' for those identification purposes. While we cannot form a ready answer as to whether labels can successfully differentiate products in all cases, we can address how the WTO agreements impose certain requirements for the conduct of authorities when they require labels, and can raise the international standard setting processes that are also taken up by the WTO regimes.

3.4 TBT and SPS regulation

The Agreement on Technical Barriers to Trade (TBT) and the Agreement on the Application of Sanitary and Phytosanitary Measure (SPS) provide specialised regimes for product and food safety requirements. They do not replace general GATT Articles, but add to these general principles and regimes. It is possible to have a case dealing with both the TBT or SPS Agreement and a general GATT obligation. However, GATT Article XX exceptions do not apply to these two agreements. Rather, they incorporate their own criteria for assessing the balance between legitimate governmental objectives and product labelling measures that may pose obstacles to international trade.

SPS Measures

Between the two agreements, the SPS Agreement is designated as *lex specialis* to the TBT Agreement. Thus, the first consideration for any labelling activity is whether it falls within the scope of the SPS Agreement.

The determination here is that the SPS Agreement does not apply at all to measures that have the objective of social or environmental protection in the country of production. While the 2006 *EC – Biotech* WTO panel (not appealed) granted the SPS a broad scope of

application, including measures that might address the environment, the QMA measures considered here are very unlikely to be related to protecting the environment of the import country.¹⁰³ According to the SPS Agreement Annex A, by definition all SPS measures must be oriented to protection ‘... within the territory of the Member ...’ This means that the only possible QMA measure that could be qualified under the SPS Agreement would be an environmental production requirement that would have some kind of cross-border or spill-over effect on the EC territory. This might fall within Annex A(1)(d)’s definition for a measure applied ‘to prevent or limit other damage’ within the territory of the Member. However this subparagraph is also designated to damage caused by ‘pests’, a term that at least suggests the need for some type of inbound component to be controlled at the border. If QMA contemplates measures that have this spill-over aspect, then they would need to be identified and then could be considered according to the SPS Agreement. For purposes here, we cannot read the SPS definitions so broadly as to encompass what are essentially general environmental measures.

Labels can also fall under the SPS regime, when as according to the Annex A definitions, they are ‘directly related to food safety.’ This definition can encompass production requirements – many SPS measures deal with quality production requirements for food processing. But the orientation on food safety also appears to eliminate any QMA labelling requirement from the scope of the SPS Agreement unless the requirement is related to protecting the quality of the final product itself. QMA measures as understood here do not seem to share the attributes of food safety standards in this manner.

TBT Measures

TBT Agreement considerations may be in play for aspects of any QMA measure that would rely upon the use of a product label, depending upon whether or not the scope of the TBT Agreement reaches to measures that are characterized NPR PPM. This has been a point of controversy in the interpretation of the TBT Agreement’s definitional annex, (Annex 1, para 1 ‘Technical regulation’), and arguments are made both ways on this question. The view taken here is that compulsory (mandatory) labels that address NPR PPM subject matter do fall within the scope of the TBT Agreement, as they, ‘include or deal exclusively with ... labelling requirements as they apply to a product, process or production method.’¹⁰⁴

¹⁰³ *European Communities-Measures Affecting the Approval and Marketing of Biotech Products*, WT/DS291/R, WT/DS292/R, WT/DS293/R.

¹⁰⁴ The argument against including NPR PPM within the scope of TBT is based upon the negotiation and drafting history of the Agreement, and upon the first sentence of the definition for a technical regulation that refers to ‘related’ process and production methods – what is referred to as ‘product related production process methods’ or PR PPM. See for example, Joshi, M., (2004), ‘Are Eco-Labels Consistent with World Trade Organization Agreements?’, *Journal of World Trade*, 38(1), pp. 69-92. For an opinion confirming that NPR PPM labels fall within the scope of the TBT Agreement, see Van den Bossche, P., Schrijver, N., Faber, G., (2007), *Unilateral Measures Addressing Non-trade Concerns*, Ministry of Foreign Affairs of The Netherlands, The Hague, pp. 145-146. This argument relies more on the system of treaty interpretation that

The coverage of the TBT Agreement to NPR PPM product labels has significance. If the TBT does not cover such labels, then only the GATT Agreement general Articles would apply - primarily Article III for National Treatment, and the Article XX General Exceptions. If, as argued here, TBT disciplines do apply to these labels, this brings forward two aspects. First is the potential for any QMA international standard setting to have a legal effect on the domestic standards of all WTO Members. Second is that the compatibility assessment in the TBT Agreement does not operate only on the basis of a discrimination analysis, but goes on to consider whether a label poses an ‘unnecessary obstacle to international trade.’ This test presents a more nuanced basis to assess a label’s compatibility with WTO law.

International Standards

Both of these aspects flow from the provisions of Article 2 of the TBT Agreement. Article 2.4 requires that WTO Members use available relevant international standards as a basis for their own domestic product regulations.¹⁰⁵ ‘Basis’ does not require a strict conformity with an international standard, but the requirement does pose as an independent TBT obligation whether or not the domestic requirement is non-discriminatory and without reference to its trade restrictiveness.¹⁰⁶ Under the TBT Agreement, an international standard is one promulgated by an ‘international body or system’ (ISB). The Agreement does not list qualifying bodies, but indicates that an international body is one whose membership is ‘open to the relevant bodies of at least all WTO Members’. Standard bodies such as Codex, ISO, and the WHO (and several others) have been consulted by the TBT Committee on guiding principles of WTO Member participation. These are generally understood to qualify as international bodies.¹⁰⁷

Trade Restrictiveness

The primary test for assessing the legality of a mandatory product label in the TBT Agreement is found in Article 2.2, which provides as follows:

Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to

has evolved in the WTO dispute settlement system. Here, negotiating history is only brought forward to clarify a provision when its meaning remains so ambiguous that a resolution cannot be made without the use of preparatory work. Our argument is that the TBT provision for technical regulations in the form of labels is unambiguous in its application to processes, especially as compared to other technical regulations that only apply to ‘related’ processes.

¹⁰⁵ Unless the standard is an ineffective or inappropriate means to achieve the legitimate objective being pursued, according to TBT Article 2.4.

¹⁰⁶ As drawn from the WTO *EC – Sardines* Appellate Body report, DS/231/AB/R. If the Member’s label is in strict conformity with an existing international standard, then this requirement is also presumed to not create an unnecessary obstacle to international trade, as according to TBT Article 2.5.

¹⁰⁷ The question of whether the EC can initiate a QMA international standard body is considered in Section Six, below.

*international trade. For this purpose, technical regulations shall not be more trade restrictive than necessary to fulfil a legitimate objective, taking account of the risks that non-fulfilment would create.*¹⁰⁸

This test provides for a type of legal assessment that is not found in other GATT Articles, and notably GATT Article XX. Although it has not been the subject of any panel or appellate body treatment in the WTO, the test as provided considers the ‘trade restrictiveness’ of a product requirement, and then appears to balance these trade effects with the legitimacy of the governmental objective being pursued by the product standard. Within that examination there is a clear statement of necessity, a term that has been interpreted on a number of occasions in WTO Article XX cases. What is added by this test that trade restrictiveness is an independent standard for legal assessment, and that this analysis appears to call for a ‘balancing’ approach that can consider whether the requirement imposed is proportional to the government’s objective. This would examine the underlying value of the objective being sought in light of the degree of trade restrictiveness being imposed by the product measure.

This balancing test has obvious implications for a QMA type of measure. If the labelling requirement does not pose a very intense restriction on international trade, then the value of the objective being pursued by the label need also not be a paramount value (such as human life) or so closely associated to avoiding a very serious or imminent risk. The more burdensome the label requirement, the more important the societal objective should be. The list of legitimate objectives is not ‘exhaustive’ in the TBT Agreement but the stated list includes possible QMA objectives, including human, animal, or plant life or health, and the environment. It is unknown at this juncture whether a label required by an import territory can seek to fulfil social or environmental objectives in the territory of production. This is asking whether extending a NPR PPM to another territory by the use of a mandatory label can be qualified as pursuing a legitimate objective within the TBT Agreement context.¹⁰⁹

QMA proposals appear to relate primarily to the use of tax instruments. To the extent that labels differentiate products, they may serve as a means to accord different tax treatment to otherwise like products. In the absence of a fiscal instrument, labels by themselves provide consumer information on the characteristics of products, and in this case their production processes. There are existing examples of EC operated NPR-PPM certification and labelling requirements, the Community’s organic food regulation appears to be one of these. While it is not the purpose of this study to promote one instrument over another, the use of labels as described above should be considered to be a possibly viable instrument either in conjunction with taxation or as a stand-alone regime.

¹⁰⁸ ‘Such legitimate objectives are, *inter alia*: ... protection of human health or safety, animal or plant life or health, or the environment.’ The listing is not exhaustive.

¹⁰⁹ A reference to social or environmental values as they find expression in general public international law may provide a basis for the legitimacy of this type of product requirement. This is discussed in section six below.

3.5 Voluntary Guidelines and Private Standards

Introduction:

A voluntary initiative to promote certain social or environmental objectives can take a number of forms, ranging from broad aspirational principles to strict benchmark requirements or standards. It is not clear whether private standards schemes may fall within the scope of the TBT Agreement. Annex 1 sets out the legal definitions for standards, conformity assessment procedures and non-governmental bodies. Article 4 requires Members take reasonable measures to ensure that non-governmental bodies accept and comply with Annex 3 to the TBT Agreement (the Code of Good Practice for the Preparation, Adoption and Application of Standards), which include notification obligations relating to the Code's acceptance and work programmes. The TBT Agreement also obligates Members to take 'reasonable measures to ensure compliance' by NGO bodies with the Code of Good Practice by non-governmental bodies.

However, the limits of the TBT Agreement ability to regulate voluntary schemes were identified in the *Tuna-Dolphin* case. Here the Panel found that the provisions of a voluntary but federally promulgated scheme did not violate Article I:1 of the GATT Agreement (MFN Clause) because the Dolphin Protection Consumer Information Act (DPCIA) could not be said to constitute a market restriction. Indeed, as a voluntary scheme it did not prevent a manufacturer from selling his product in a marketplace without complying with the environmental requirement. The conclusions of this dispute indicates that not only is it necessary for a violating measure to restrict market access, but that any advantage gained by one exporter over another exporter must be conferred by the government implementing the measure - not alone by consumer preference. Disputes between private entities, NGOs and non-state organizations are beyond the mandate of the GATT Agreement.

It is our opinion that only advantages that are 'government conferred' are subject to the MFN requirement. This does not apply to voluntary guidelines or private standards unless the necessary attribution can be made to a government in promulgating these standards. State attribution is discussed below in Section 5.3.

3.5.1 The TBT Code of Good Practice

According to Article 4 of the TBT agreement and its application in the annexed Code of Good Practice, Member states are responsible for insuring TBT compliance for private standard setting bodies that operate at the national (central) level. They are not responsible for insuring that all sub-national standard bodies adhere to the Code of Good Practice, but do assume a stated obligation to 'take such reasonable measures as may be available to them' to ensure compliance with the Code of local governmental and non-governmental

standard bodies within their territories.¹¹⁰ While this does not say that the Member is responsible for non-governmental and non-centralized bodies that fail to adhere to the Code, we would still not accept the proposition that all private standard bodies are therefore ‘out’ of the TBT agreement’s disciplines as a result, or more important, that Members are necessarily relieved of responsibility in all cases in which non-governmental bodies within their territory refuse to adhere to the Code.

The definition of what constitutes the ‘reasonable measures’ that Members are obliged to take to encourage compliance by non-governmental bodies differs from case to case. Yet where a government has not taken any measures whatsoever to induce standard bodies in adhering to the Code, it is also possible that a Member assumes some responsibility for this omission, especially if the reasonable measures considered are likely to be effective to induce a standard setting body to accept the Code’s requirements. For instance, should a government ensure that its private standard bodies are informed of its policy to promote adherence to the Code, or provide a governmental contact point to advise on Code requirements? Or, is it deemed reasonable for a government to request (or require) that private bodies operating within its territory duly inform the government of any TBT nonconforming standards or other non-conforming procedures? This is just to suggest a level of state responsibility in the TBT Article that might go a step beyond GATT/WTO’s more general conditions for assigning state responsibility for private actors.

There are theories of state responsibility under general international law as well as in WTO law not falling within the TBT provisions (discussed below) which can raise a state into the position of violating WTO provisions in respect of a private body.

3.5.2 State Attribution

The scope of state attribution in the WTO regime is at present interpreted narrowly. In the *Japan-Films* dispute, the WTO Panel acknowledged that there were no ‘bright line rules’ that allowed it to rule out an action as being non-governmental, just because it was taken by a private party. In the *Korea-Beef* dispute, Korean retailers responded to a government law introducing a dual retail system by voluntarily renouncing the sale of imported beef because of commercial considerations. Although the voluntary actions of the retailers could not be attributed to the State, the WTO Appellate Body held Korea responsible for violation under Article III:4 (National Treatment) because domestic law gave a sufficient incentive for its retailers to act in a WTO-inconsistent way.

As a point of reference, both the SPS and the TBT Agreements offer different approaches to identify the criteria by which States should be held accountable for the misuse of private voluntary standards. While SPS measures are not within the scope of this research, Article 13 of the SPS Agreement is instructive to the discussion here because it states that

¹¹⁰ The TBT Code of Good Practice mimics the TBT Agreement obligations discussed above. Adherence to the Code means that the standard body adopts the requirements of the TBT Agreement for all points here under discussion.

Members ‘shall not take measures which have the effect of directly or indirectly, requiring or encouraging...such nongovernmental entities...to act in a manner inconsistent with the provisions of this Agreement’. Alternatively, the TBT Agreement affixes gradual levels of state responsibility relating to the extent of control that a State can exercise over a non-governmental body.

However, WTO jurisprudence displays the reluctance of the DSM to hold a State responsible for the trade-restricting activities of private parties within its territories, even if such activities were directly or indirectly supported by a governmental measure.¹¹¹ Although the *Japan-Films* findings found no ‘bright line rules’ to exempt private party actions from WTO scrutiny and the Panel acknowledged that a government’s measures could assist such cartels by limiting exports, it did not incorporate a ‘due diligence’ requirement into Article XI:1 to ensure that State’s laws did not enable private parties to restrict trade.

3.5.3 Conclusions

While mandatory government standards are subject to the constraints of the MFN and NT non-discrimination provisions it is not clear that these disciplines extend to private voluntary standards, even when these standards are capable of discriminating against exporters and therefore changing the level of competition in these markets. It is not clear whether private standards schemes fall within the scope of the TBT Agreement. Annex 1 sets out the legal definitions for standards, conformity assessment procedures and non-governmental bodies. Article 4 requires Members take reasonable measures to ensure that non-governmental bodies accept and comply with Annex 3 to the TBT Agreement (the Code of Good Practice for the Preparation, Adoption and Application of Standards), which include notification obligations relating to the Code’s acceptance and work programmes. The TBT Agreement also obligates Members to take ‘reasonable measures to ensure compliance’ by NGO bodies with the Code of Good Practice by non-governmental bodies.

It is our opinion that the success of a contested private standard or guideline under Article III will depend on how widely state attribution is interpreted. If the interpretation is broad there is a case for challenging private standards under Article III:4. It is our opinion that it would be difficult to show that a private standard violates Article III:4 because the measure must be shown to constitute a law, regulation or requirement that affects internal sale, discriminates between ‘like’ products and does not afford ‘like treatment’ to imported products. A private action can be interpreted as a ‘requirement’ under Article III:4 only if ‘there is a nexus between that action and the action of a government such that the government must be held responsible for that action.’ This nexus can be established by private standards supported by government policy. In the case of a proposed QMA scheme relying upon private standard bodies, if contested, state attribution would most likely be

¹¹¹ *Argentina — Measures affecting the export of bovine hides and the import of finished leather* (DS155/R). 19 December 2000.

determined, and consequently the scheme would be found to be in violation of Article III:4, as discussed above.

3.6 The Role of International Agreements

Introduction

Some QMA aspects discussed in this part of the report above touched upon the relationship between WTO law and other public international law instruments. One such area deals with the role of international agreements as they relate to the interpretation of general GATT Articles, including exceptional defences that are raised under GATT Article XX. Another area concerns the TBT Agreement's relationship with international standard bodies in granting those international standards a certain legal effect among WTO Members, and for possibly assisting to legitimize the social and environmental objectives being pursued by the EC in a QMA regime. A third area considers the existing EC general system of preferences (GSP). Within all of these subject areas there are points of reference to existing international regimes and agreements to which the European Union and its member states are participants. A guiding theme for both subject areas is that relevant international agreements that are widely adopted should be considered as a primary point of reference for determining the subject content of any QMA measure.

3.6.1 GATT Articles and other international law

General GATT Articles

This area deals first with general GATT Article obligations such as national treatment and most-favoured nation. A first consideration here is whether any international public law point of reference can be raised to support the criteria for 'likeness' that might validate a product differentiation based upon 'consumer tastes and habits'. While this criterion is understood to relate to the actual marketplace of the Member concerned, that fact that a Member is also choosing to participate in international bodies and agreements to promote certain social and environmental rights can also be reflective of that Member's collective consumer tastes and habits.

Related, the list of factors taken up by the Appellate Body to determine likeness is not a 'closed list'. The AB has indicated that other factors as may be relevant should be raised and considered in any given case. Where a WTO Member is committed to an international regime, this could be suggested as a 'new' factor to be considered on product differentiation in the appropriate case. Although 'other international law' has not been used in a likeness determination in any WTO case so far, there is no reason why it cannot be raised if a relevant international norm or principle can be identified. If the parties in a WTO like-products case are both signatories to a relevant international accord, then it is also possible that the values expressed in that other agreement can be introduced as a new factor as a matter of 'other applicable law' between the parties, within the meaning of the Vienna Convention on the Law of Treaties (VCLT Article 31(3)(c)). This would be asking a panel to interpret product likeness in light of other applicable international law.

Article XX Considerations

A final subject area for GATT Articles goes to the validation of a GATT unlawful measure under Article XX and its particular exceptions. Here, international law has already been used to interpret the term 'exhaustible natural resource' as discussed above for Article XX(g). The gateway employed by the AB to consider other international law was, at least in part, the objectives expressed in the WTO preamble (by all Members) and also noting the evolution of the WTO preamble from the original GATT. In a similar attempt to bring forward the interpretational context of another international agreement, the EC argued unsuccessfully in the *EC-Biotech* panel case that other international law could be applied to interpret the precautionary principle in the SPS Agreement. In that case, the panel treated the question according to Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT). This says that the interpretation of a treaty provision can take account of 'any relevant rules of international law applicable in the relations between the parties'. It found however that all WTO Members would need to be parties to the other international agreement for it to be qualified for consideration as 'other applicable law' in a WTO dispute case.

This panel reasoning has been criticized as posing an impossible requirement for a multilateral Membership as large as the WTO, and it may be that the better rule, as proposed by the International Law Commission, would be that 'applicable law' should refer to other international agreements as adopted (only) by the parties to actual WTO dispute.

This raises the issue of whether a WTO Member can defend a GATT violation on the basis of other international law, and how that defending measure would be raised. For example, where the complainant and the EC (as respondent) were *both* signatories to the 1998 ILO Declaration on Fundamental Principles and Rights at Work, then would it be possible for the EC to defend its use of a NPR PPM measure within Article XX (a) or (b) on the basis of its assumed obligation to give effect to this international declaration? This is considered both in the context of whether the international obligation is bound to be given effect only within the territory of the enacting Member, but also whether the Member's law – when applied only to its own territory – can be shown to be undermined by actions and effects of non-compliance by other Members. This last point recalls the discussion in Section Four above regarding a defence according to Article XX(d).

3.6.2 The TBT Agreement and international standards

International standard bodies

For the TBT Agreement, one considers first whether there are any existing international bodies that are already establishing (or capable of establishing) NPR PPM labelling

standards that might be applicable in a QMA scheme. This analysis requires a targeted definition of which specific values and criteria the QMA is proposing to assess upon agriculture products, and whether any such standards have been promulgated by a recognized international standard body. The EC and its Member states are bound to apply any such standards as a basis for their own technical requirements when they choose to have them. They must also apply those same standards to the products of other territories on a non-discriminatory basis.

There is a second possibility that international bodies that are not directly setting product standards *per se* may nevertheless be relevant for the purpose of QMA criterion. Thus for example, the EC and its member states' adherence to certain conventions of the ILO, which are international standards, can be argued to provide the legal basis for establishing product labels. Albeit, this is one step removed from the TBT Annex definition where an international body is defined as one that sets the product standards.

The question raised is whether this type of approach in referencing to other international law can serve as the basis for 'process standards' that would allow the EC to then draw distinctions for products by using labels and then differential tariffs. Thus for example, while one understands that the ILO is not an international standard setting body, it is nevertheless an international body 'open to all WTO Members' and its normative frameworks, at least those that are widely accepted in the international community, may serve as a criterion for developing product labels. Likewise, some international bodies, like the ILO, already provide for institutional machinery that monitors and reports on state compliance. This provides an additional international point of reference for the EC to consider if it chooses to engage in a certification process on the basis of country origin.

A QMA standard body

A means of closing this secondary linkage is for an international body to be established solely for the purpose of creating QMA labels. Such a body would fall within the TBT definition (whether public or private) where it would be made open to the relevant (standard) bodies of all WTO Members.¹¹² As enunciated by the TBT Committees 2d bi-annual review, the emphasis is on the 'process' of ensuring WTO Member participation in the activities of the standard body. These recommendations made by the TBT Committee may not have a normative legal effect in WTO law, but any WTO case dealing with whether or not a standard qualifies as an international standard would likely consider the participation recommendations as an informative indicator.

¹¹² We do consider that certification activities would qualify since that part of the TBT Annex definition refers to 'related processes'. Thus the focus is on labeling.

3.6.3 EC GSP, QMA and international agreements

There is an existing EC regime for referencing international agreements and protocols in the form of the GSP ‘plus’ system.¹¹³ Here we see a number of specified human, labour, environmental and governance conventions and protocols that are used as qualifying benchmarks for developing country to participate in this advanced preferential system.¹¹⁴ These agreements referenced by the GSP system are not setting product requirements, but are using international legal references to set criteria for tariff-duty treatment. In this sense there is a similarity to a QMA system that also contemplates setting different tariff rates based upon environmental and social factors.

The GSP ‘plus’ system is raised here as an example of international ‘rule referencing’, which might have some applicability to a QMA approach, assuming that either some of the referenced conventions in the GSP Regulation would also be applicable to the QMA context, or that there might be others that are relevant. However, the fact that an existing EC Tariff arrangement is using similar or the same international agreements as would be the QMA concept is not a pass on QMA legality, and may itself cause an additional legal conflict for the EC.

First as to the difference between the GSP system and most-favoured nation elements that have been raised in the first section. The differentiation allowed to meet the special development needs of grantee developing countries in the GSP is WTO ‘lawful’ within the context only of the General System of Preferences (The Enabling Clause, Decision of 1979). This is not the same as generating distinctions between countries in the context GATT Article I MFN. Providing different preferences to different WTO Members is a violation of Article I MFN. GSP is an exceptional regime that allows this differentiation according to its own requirements. Within GSP and as to the group of developing country recipients, there is a certain degree of differentiation permitted to meet the different developing needs of the recipient countries. These differences must reflect the actual needs of the countries and also be based upon criterion that is widely endorsed in the international community, such as multi-party international agreements.

Conflicts between the two regimes become apparent to the extent that a QMA tariff preference (tariff increase) would be addressing some of the same developing countries with some of the same international requirements in the form of listed conventions and protocols. First, in the MFN context a country by country system of certification becomes a red flag for an Article I violation. The only hope of imposing conditions on MFN would be to maintain those requirements as oriented to products and producers, but not countries. It can be possible for a country to certify as a whole for all its producers, but if the regime is based solely on country certification then discrimination is much easier to find on the basis of origin. GSP may not have this problem but MFN does.

A second conflict occurs in the case that a GSP plus recipient country is receiving the positive tariff preference, but then is unable to meet some different obligation in the QMA

¹¹³ Council Regulation 980/2005 of 27 June 2005 [2005] OJ L169/1.

¹¹⁴ The list of conventions is attached in the Annex.

context. On one hand a country is being rewarded for meeting certain international requirements and then on the other hand being 'punished' for not meeting certain other requirements. If that second set of requirements do not meet the criteria for granting or denying GSP plus – i.e., that they are not addressing the developmental needs of the beneficiaries, or are not broadly endorsed international standards, then it is conceivable that an existing GSP recipient might challenge the QMA as unlawful measure in respect of the GSP system.

This means that for GSP beneficiaries, (all developing countries) it may be necessary that the two regimes be matched regarding their international requirements. But if so, then one can also ask what QMA would be adding to what is already there in the GSP plus - a listing of international agreements that when qualified grant the recipient better market access to the EC. Implicitly, this means that those countries not qualifying have lesser market access benefits (relatively higher tariffs), so one could suggest that the regimes are essentially the same in overall effect, at least if they are operating on the same set of international requirements. From this view, the only difference between the two is that QMA is a mandatory (involuntary) regime (a stick), whereas GSP plus is a voluntary regime and functioning more like a carrot.

3.7 Conclusions from the legal analysis

The QMA proposals incorporate some of the most controversial trade law issues circulating in the WTO. There is no question that differentiating products on the basis of NPR PPM is an intense subject area for almost all of the WTO Members, pro or con. This said, the orientation here has not been to find those points where the QMA proposals can be ‘shot down’ under WTO law. Rather, we are consciously trying to test those areas where this type of differentiation might survive what one can assume would be an inevitable dispute panel challenge to any enactment of a QMA arrangement.

While we think that there are likely violations on most if not all points discussed in the opinion above, some are more obviously egregious than others. For the general GATT Articles, breaking a tariff binding is about as blatant a violation of a GATT obligation as one can imagine. It calls forth the core contractual aspects of the GATT and required compensation by the EC or retaliation by the affected Member is a likely result. Differential tariff treatment, whether or not a binding is violated, probably comes in a fairly close second, but as suggested here, there is at least a more narrow ‘like product’ analysis possible to consider for tariffs than for the comparable national treatment cases under Article III, and the tariff differentiation may also not discriminate against (the group of like products originating in) particular countries.

For domestic regulation under Article III, our conclusion is that tax or regulatory distinctions based on NPR PPMs are not likely to survive a like-product analysis. We know there are arguments to the contrary and that the single factor of consumer tastes and habits may offer some potential for product differentiation. But for now, the emphasis in modern Article III cases on competitive relationships among essentially identical products still governs the outcome, which is that a NPR PPM measure would not pass the like product test. We also know that differences in treatment among a larger group of domestic like products must still be shown to be receiving more favourable treatment than the comparable group of imported products. Here we recognize the possibility of differential treatment within the like product grouping, but are necessarily tentative when we do not know how cases based on this ‘group’ identification standard would actually be treated in the practice. It is conceivable that the regulatory differences based on NPR-PPM distinctions could be validated in this newer approach.

The outcome is less pessimistic for Article XX considerations. Here it has been argued that the measure being justified should be based, as much as possible, on non-origin criteria (certifying products and producers rather than countries). In the same vein, if there is any international normative support for the underlying distinctions, this also may tend to be supportive.

For us, labels are raised as a primary form of differentiation either for importation purposes or for consumer information in the marketplace. We see labels as the nexus that allows consumers to make their differentiated choice. While we do not say that certification labels can successfully differentiate products in any given case, without the ‘identifier’ it is

difficult for us to imagine how a QMA scheme relying either on customs taxes or on regulatory distinctions could be put into effective operation.

For this reason, we assess labels for their own WTO requirements, both in the context of the obligations contained in general GATT Articles, and within their own specialized regime in the TBT Agreement. We have discussed above our rationale for concluding that the SPS Agreement is not applicable to a QMA measure, unless the protection sought is located within the country of importation, which we believe to be a remote possibility.

As contrasted to general GATT Articles, the TBT regime offers the more interesting possibilities for redeeming NPR PPMs. It is a pre-condition to this opinion that NPR PPM labels fall within the scope of the TBT Agreement. While we understand that the negotiation history of the TBT definitional annex may not be so supportive of this finding, the definitional text itself is not ambiguous - and not ambiguous enough to justify calling forth negotiation history as a necessary means to clarify the meaning of the provision. The simple reading of the paragraphs within their immediate context supports coverage for these types of labels within the TBT Agreement. If so, then the TBT Article 2.2 and 2.4 regime is applicable.

What may hold some preliminary promise at this stage of the analysis, is that the list of 'legitimate objectives' within the TBT regime are not pre-designated and 'closed'. In addition, the burden of establishing that a measure is more burdensome than necessary to fulfil a legitimate objective may initially rest upon a complainant. The TBT Agreement also holds out the possibility of an international standard setting body generating label requirements for NPR PPMs. This is obviously a longer-term consideration, but if these labels do fall within the scope of TBT, then this means that international standards dealing with such labels would be essentially compulsory for all WTO Members who choose to use such labels.

We also examined private standard setting according to the TBT Code of Good Practice. We suggest that state responsibility for these activities may be a factor where states do nothing to encourage private standard setting bodies to conform to the Code. What might also be suggested is that private bodies already engaged in NPR PPM labelling standards could be actively brought into the process of internationalizing the process of standard setting so that they themselves may qualify as international bodies according to the TBT rules. This would require the active participation of WTO Member governments. Perhaps this is a role that QMA advocates can see for the EC.

Throughout this part of the study, we have attempted to demonstrate that international action is more viable than unilateral action. Although there are a number of unknowns in the relationship between WTO law and international law, there is clearly a relationship. While basing QMA criteria on international regimes is no guarantor of WTO legality for any particular trade measure, any QMA measure that ignores the international legal context does so at its own risk. It is nearly inconceivable that a QMA validation could be established in the WTO without reference to the public international law governing environmental and social protection.

Chapter 4. Final Conclusions

The bottom line of the economic analysis is that we do not find evidence of pressures for a race to the bottom that would suggest that QMA is a proportionate response, although it is not for this paper to suggest political priorities. We are therefore left with the possible justification of QMA as a response to collective preferences in the EU with respect to what is consumed here and EU collective preferences with regard to other countries' standards. We cannot see direct evidence in *market* behaviour of such preferences.

Our provisional economic conclusion is that if a clear political case exists that the import of unfairly produced goods creates psychic disutility within the EU to those who see others consuming unfair products, a logical case can be made for the QMA proposal. But if our primary concern is for the welfare of the environment and social norms elsewhere, and we believe this is a development priority we must be willing to pay for it directly rather than by taxing imports from developing countries. The link between the subsidy and tariff revenue, whilst politically appealing, lacks economic logic. If our QMA tariffs excluded all imports from developing countries, should we give no aid in this area?

Our legal analysis tells us that there might be ways in which the QMA plan could be made WTO compatible, but it would be legally and diplomatically highly problematic and certain QMA measures would only be possible if our partners agreed to them and the EU compensated them directly as well as via any tariff revenue handed over. Different forms of QMA raise different problems. Unilateral increases of MFN tariffs would clearly be unacceptable to our partners, while more subtle mechanisms might find a legal basis. We cannot therefore rule out the possibility that some versions of QMA would be defensible at the WTO, even though many are clearly WTO-illegal, but this would be a shaky basis for a policy.

Ultimately we would suggest that the most compelling case against any moves to raise bound tariffs to penalise exporters to whom we have made WTO commitments to allow market access at scheduled tariffs is a systemic one. It is at the limit of our mandate to speculate on the likely response of other members of the WTO but we can offer the judgement that our trading partners would be most unlikely to agree to modify the WTO Treaty to allow this. The Indian Commerce Minister said in 2001:

*'..on environment we are strongly opposed to the use of environmental measures for protectionist purposes and to imposition of unilateral trade restrictive measures. We are convinced that the existing WTO rules are adequate to deal with all legitimate environmental concerns. We should firmly resist negotiations in this area which are not desirable, now or later. We consider them as Trojan horses of protectionism.'*¹¹⁵

¹¹⁵ http://demotemp279.nic.in/trade/international_trade_statements_doha_1.asp

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APPENDIX 1

Jongeneel, R. Summary report for CROSS-COMPLIANCE project, EU 6th Framework Programme, Priority 8.1 (European Commission, DG RTD, contract no. SSPECT-2005-006489).

Jongeneel et al provide estimates for seven agricultural sectors of the costs of compliance with a series of EU and environmental and animal welfare regulations. Labour and social standards are excluded. The particular point of the study is precisely to assess the impact of costs of compliance with EU regulations and the consequent impact on trade flows using a GTAP model.

The background of the study is that requirement that in order to receive the new single farm payment farmers must comply with a set of norms known as the Statutory Management Requirements. These are 19 pre-existing items of EU legislation which may not have been fully implemented in the past. Hitherto there have been fines for non-compliance but with the introduction of the Single Farm payment SFP there is an additional penalty of loss of the SFP. The measures include the Nitrates Directive and pig and poultry welfare measures. In addition to these individual MS could introduce mandatory Good Agricultural and Environment Condition (GAEC) standards. The study notes that one must distinguish between the *compliance* cost of the introduction of the rules and the additional costs due to more severe enforcement due to cross compliance.¹¹⁶ For the SMRs costs can thus be divided into costs currently incurred (some of which may be sunk costs) vs additional costs as there is a move towards 100% compliance. The GAECs are in most but not all cases *new* requirements largely affecting arable farming. The study also examines the compliance costs with the mandatory standards in place in the US Canada, Australia and New Zealand but not Brazil.¹¹⁷ The study notes that for competitiveness it is the relative costs that matter. Hence in those cases where the US has a more costly requirement than the EU there is no loss of competitiveness.

The study examined the following sectors and measures.

Dairy

- Nitrates (EU, non-EU) • Identification and Registration (EU)
- Food Safety (bST) (non-EU)

Beef

- Nitrates (EU) • Identification and Registration (EU)
- Food Safety (growth hormones) (non-EU)

Pigs and poultry

- Nitrates (EU)
- Animal Welfare (EU)
- Clean Water (non-EU)

Cereals

- GAEC Standards (EU, non-EU)

Fruit vegetables and olives

¹¹⁶ Farmer 2007 stresses that the main costs are the original costs of applying the directives. Farmer, M. (2007) *The Possible Impacts of Cross Compliance on Farm Costs and Competitiveness*, Deliverable 21 of the CC Network Project, SSPE-CT-2005-022727. http://www.ieep.eu/publications/pdfs/crosscompliance/D21_Cross_compliance_costs_and_competitiveness.pdf

¹¹⁷ It would have been useful for the purposes of the QMA debate to have Brazilian data since this is seen as a major competitor, but see below on eggs.

- Nitrates (Spain) • Plant Protection (Spain)
- GAEC Standards (in particular, water conservation in Spain)

We may summarise the finding as follows:

Summary of main findings for the dairy sector

'At sector level full compliance to the nitrates standard for all affected farmers would involve a percentage cost of production increase of 0.2 to 0.5 percent, with rates varying between Member States (with Italy being an exception and facing a higher average percentage cost increase of about 4 percent).'

Summary of main findings for the beef sector

'The Nitrates Directive affects 4.2% of beef cattle raised in intensive finishing farms and 3.0% of beef produced on cow calf farms. This low percentage of farms affected by the Nitrates Directive explains the limited sector cost increase, which has been estimated to be 0.095%. The relatively low cost impact associated with the standards arising from the Nitrates Directive does not have a significant consequence for the competitive position of the EU beef production on the world market. The regulations concerning the identification and registration of beef cattle are highly relevant to beef farms. Implemented as a reaction to the BSE crisis the beef farmers have to register all cattle movements and make sure that all animals are correctly identified.'

Summary of main findings for the cereals sector

'As regard the cereals sector, the estimated percentage cost increases associated with the GAEC standards are in all cases less than one per cent of total production costs.'

Total world trade would hardly be affected by the impact of the GAEC standard (although it is likely to be affected by changes to the set-side policy)

Summary of main findings for the pig and poultry sectors

'As the pig and poultry sectors are the most intensive livestock activities in the EU it is quite comprehensible that these sectors are the most affected by the Nitrates Directive. In the present analysis the effects have been quantified only for the pig sector, as poultry farms are very marginally touched by cross compliance. The overall EU cost increase to be attributed to the pig sector assuming if full compliance with the Nitrates Directive is attained has been estimated to be 0.55%. Such a cost increase results in a significant impact on the EU trade balance of pigmeat.A comparison was made with the impact of the Clean Water Act in the US. This Act raises the cost to the US pig sector by 1.08%, almost double the impact of the Nitrates Directive in the EU.'

A calculation of the cost of achieving full compliance with the animal welfare regulations for all pig farmers in the EU shows that the cost increase would be very limited. The reasons for this minor cost impact are the high degree of compliance with the standards and the limited rise in costs for farmers who still have to adapt their farm to the new legislation. At farm level the cost increase is well below 1% and this generates a rise of costs at sector level of 0.11%.'

The Jonegeneel study was intended to analyze the effects of cross compliance rather than the move from zero compliance to full compliance and it does not contain comprehensive estimates of the costs EU farmers were bearing before the additional cross compliance requirements came in. The

study excluded the poultry sector because that was not affected by *cross* compliance. Some data is available. Table 3.2 estimates that the costs of compliance with the nitrates directive in 2003 were between 1.1 and 3.6% of total costs for dairy farmers. Estimates of the exports for egg farmers are hard to read from the study, as the conclusions depend on how many farmers are affected. And the study goes into fewer details on that. They note that egg production is not affected by cross compliance

'Of course this does not mean that the laying hen sector is not affected by EU animal welfare regulations. As this is going beyond the scope of this study mention should be made only of the regulations which impose the use of enriched cages for laying hens before 2012. This change over will generate considerable costs for the egg production sector in the EU and may affect significantly the competitive position of EU egg production on the world market (Van Horne & Bondt, 2006). It should however be stated that world trade in eggs and egg products is still very limited and has been estimated in 1.8% (Windhorst, 2006). The large majority of eggs are traded between EU countries and among some Asian countries, but very small to negligible quantities of eggs are traded between continents. The only relevant trade which may increase in the future is the trade in egg powder, where countries like Ukraine, Brazil and India may create a competitive advantage in future'

The study does not suggest that the costs are negligible and will have no impact on trade

'Aggregating all trade balance impacts generates a total reduction in value of the considered products and measures of 373 million dollar.' P. 84

However the analysis was conducted in a general equilibrium framework and the indirect effects on the rest of the economy must be taken into account.

'Moreover, when looking to the overall trade balance impact, taking into account the spill-over effects to other sectors (e.g. food industry, etc.) in the EU economy, the net impact is almost zero. These latter spill-over or indirect effects [...] reflect internal competitiveness effects (i.e. changes between the relative position of different sectors like the food sector, the manufacturing sector, etc.) within the EU economy. As the Table shows these effects appear to be positive and largely compensating for the direct effects experienced in the primary production sectors.'

Price premium reported in the literature by Galarraga (2002)

Country	Information	Study
United Kingdom	33% of the surveyed public willing to pay an average of 13% premium for sustainably produced timber	Survey carried out by MORI and WWF quoted by Simula (1997) in Zarrilli <i>et al.</i> (1997)
United Kingdom	25–50% of the Britons ready to pay up to 25% premium for (credible goods with improved environmental performance	Quoted by Peattie (1995)
United Kingdom	Of consumers surveyed [. . .] premiums suggested (for ethical products) ranged between 10 and 18 pence	Mintel (1994)
United Kingdom	Cafédirect has a price premium of 5–10% over commercial premium brands of coffee	Bird and Hughes (1997)
United Kingdom	Consumers willing to pay a 13% price premium for tropical timber products	Haji Gazali and Simula (1994)
Europe	Consumers willing to pay a 5–15% premium for sustainable timber products	Varangis <i>et al.</i> (1993)
Europe	37% of consumers said they would be prepared to pay a premium of 10% for bananas of equivalent quality produced according to fair trade standards	COM (1999)
Canada	64% of respondents willing to pay a 10% premium for a product bearing the Ecologo	Hickling Corporation public survey (1993) quoted by Guevara <i>et al.</i> in Zarrilli <i>et al.</i> (1997)
Singapore	5% premium for the Singapore Green label	Jha <i>et al.</i> (1993).
United States	34% of consumers surveyed willing to pay a 6–10% price premium for sustainable wood	Winterhalter and Cassens (1993).
United States	75% of consumers surveyed willing to pay a 1–5% price premium for sustainable wood	Survey by Gerstman and Meyer quoted by Crossley <i>et al.</i> in Zarrilli <i>et al.</i> (1997)
United States	57% of the surveyed public willing to pay a 1–5% price premium for sustainable wood	Survey by Purdue University quoted by Crossley <i>et al.</i> in Zarrilli <i>et al.</i> (1997)
United States.	82% of consumers ready to pay 5% premium for ‘greener’ products	Walker Thompson quoted in Levitt (1990)
United States	Willingness to pay for environmental/health attributes on food between 5 and 7%	van Ravenswaay and Hoehn (1991)

APPENDIX 2

Net Welfare Effects in Europe in presence of an externality

	Don't care about foreign externality		Care about impact of foreign externality on our consumption		Care about externality globally	
	European preferences homogenous	European preferences not homogenous	European preferences homogenous	European Preferences not homogenous	European preferences homogenous	European preferences not homogenous
Domestic Standards (Figure 1)	Net benefit d	Uncertain depending on how many dissenters there are $1-\theta(a+b)-c < d$	Net loss i On imports Not removed -d	Smaller net Loss depending on how many do not care $-(1-\theta)d$		
Tariff without exceptions after standard in place baseline is welfare after standard introduced (Figure 2)	Welfare loss -d-g	Welfare loss -d-g	Welfare gain $\frac{1}{2}h$	Welfare Uncertain Depending on size of θ and ϕ $J-(1-\theta)K-\phi(1-\theta)(i+h)$ ¹¹⁸		
Standard plus tariff and no exceptions baseline pre standard welfare Figure 2	Welfare Loss reduced by benefit of standard -g	Uncertain depending on size of θ $1-\theta(a-b)-g > -g$	Welfare Uncertain $\frac{1}{2}h-d$	Uncertain depending on size of θ and ϕ $J-(1-\theta)K-\phi(1-\theta)(i+h) < (\frac{1}{2}h-d)$		
QMA - tariff suspended for foreign compliers cost of compliance	Welfare loss compared with Tariff and no	welfare loss of e+f	Welfare Neutral As loss in tariff revenue to	Welfare Loss $\phi(1-\theta)i+(1-\theta)i-e-f < 0$		

¹¹⁸ $J = c+d+e+f+g$; $K = a+b+i+h$

same as Europe (Figure 2)	exemption lose (e+f) and no gain from foreigners meeting the standard		foreigners compensated by gain from externality being removed or imports $e+f=i$			
QMA- tariff suspended for foreign compliers; cost of compliance higher than Europe need to subsidise RoW exports (figure 2)	Welfare Loss $e+f$ as above	Welfare Loss $e+f$ as above	Welfare Neutral As benefits of foreign exporters to the EU meeting standard (i) offset by loss of tariff revenue $e + f$	Welfare Loss $\phi(1-\theta)i + (1-\theta)i - e - f < 0$		
Exporting The Standard (Figures 2 & 3)						
Relative to existing EU standard	Welfare Loss From increase in the world price $-y$	Welfare Loss From increase in the world price $-y$	Welfare Gain $e-y$	Uncertain depending on size of θ $(1-\theta)e-y$	welfare gain $2e-y$	Uncertain depending on size of θ $1-\theta(2e)-y$
Relative to no EU standard	Uncertain $d-y$	Uncertain $1-\theta(a+b)-c -y < d-y$	Welfare gain $(a+e)-c' -y$	Uncertain depending on size of θ $1-\theta(a+e)-c' -y$	Welfare gain $(a+2e)-c' -y$	Uncertain depending on size of θ $1-\theta(a+2e)-c' -y$

Note that if the rest of the world share European preferences and value the externality also at C then they too are better off and global welfare will be higher to the extent of C times global production less the cost of the increase in price from P_w to P_w^1 . If the world values the removal of the externality at less than $P_w^1 - P_w$ then they lose and those losses are may swamp any gains in Europe from the standard.

APPENDIX 3

Conventions referred to in Article 9 of the EU GSP Regulation

Core human and labour rights UN/ILO Conventions

1. International Covenant on Civil and Political Rights
2. International Covenant on Economic, Social and Cultural Rights
3. International Convention on the Elimination of All Forms of Racial Discrimination
4. Convention on the Elimination of All Forms of Discrimination Against Women
5. Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment
6. Convention on the Rights of the Child
7. Convention on the Prevention and Punishment of the Crime of Genocide
8. Convention concerning Minimum Age for Admission to Employment (No 138)
9. Convention concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour (No 182)
10. Convention concerning the Abolition of Forced Labour (No 105)
11. Convention concerning Forced or Compulsory Labour (No 29)
12. Convention concerning Equal Remuneration of Men and Women Workers for Work of Equal Value (No 100)
13. Convention concerning Discrimination in Respect of Employment and Occupation (No 111)
14. Convention concerning Freedom of Association and Protection of the Right to Organise (No 87)
15. Convention concerning the Application of the Principles of the Right to Organise and to Bargain Collectively (No 98)
16. International Convention on the Suppression and Punishment of the Crime of Apartheid.

Conventions related to the environment and governance principles

17. Montreal Protocol on Substances that Deplete the Ozone Layer
18. Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal
19. Stockholm Convention on Persistent Organic Pollutants
20. Convention on International Trade in Endangered Species of Wild Fauna and Flora
21. Convention on Biological Diversity
22. Cartagena Protocol on Biosafety
23. Kyoto Protocol to the United Nations Framework Convention on Climate Change
24. United Nations Single Convention on Narcotic Drugs (1961)
25. United Nations Convention on Psychotropic Substances (1971)
26. United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988)
27. United Nations Convention