

International and Regional Trade Law: The Law of the World Trade Organization



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Unit IV: Tariffs and Customs Law / The Most-Favored Nation Principle

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The Law of World Trade Organization
Unit IV: Tariffs and Customs Law / the Most-Favored Nation
Principle

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Guiding Questions

Reflect on the following questions while/after reading the material:

1. LAN Case

- a. How would you classify a newly invented or designed product which does not appropriately fall within any of the existing headings or sub-headings (classification units of the tariff schedules)? Would you negotiate on a new (sub)heading or select the closest one yourself? Would such selection belong to “sovereignty”?
- b. Would the concept of “legitimate expectation,” which the Appellate Body viewed falls within a non-violation complaint and thus rejected, be different from such expectation as Member countries generally retain as to the equality of opportunities in the competitive relationship whose concept constitutes a conceptual basis of Article III (National Treatment) jurisprudence? (See Unit 6)
- c. (How) could the Appellate Body otherwise have completed the legal analysis? In the alternative, could one construe some kind of remand authority in the Dispute Settlement Understanding?

2. Most-favored-nation principle

- a. Think about the practical value of the MFN principle in the process of the multilateral negotiations. Also consider the criticism of “free riders” and the political need for the “preferential” or “conditional” treatment.
- b. GATT Art. I:1 applies not only to border measures, but also to internal regulation and taxation (see the cross-reference to Art. III). How does one distinguish between tariffs and (discriminatory) taxes? In what cases is the cross-reference relevant?

3. Spanish Coffee and Japan – Lumber

- a. To what extent do the two panels take different approaches, to what extent do they apply the same rationale? (Hint: Measure v. Product)
- b. Is classification an issue of sovereignty? What national policies are involved?
- c. What role do (suspected) legislative intent and purpose play? What is the relevance of the practice of other countries? Is the “like product” test applied objectively?
- d. What is the legal significance of the predominance of particular products among the exports of the complaining countries in the two disputes?

4. EU – GSP

- a. India dropped most in-flammable complaints against the EU, i.e., special incentive arrangements for the protection of labor and environment. Why?
- b. Was the Appellate Body concerned on any negative effect on future GSP program when it modified (or mollified) the initial harsher decision by the Panel?
- c. How would the EU implement the Appellate Body’s decision?

1. Tariffs and Customs Law

1-1. INTRODUCTION

Relevant Provisions

Read in the Primary Sources:

- GATT 1994 Article II
- The interpretive note *Ad Article II*
- GATT 1994 VII
- The interpretive note *Ad Article VII*
- The introduction and Articles 1-8, 18-19 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994
- The Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994

Overview

http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm2_e.htm

Tariffs - more bindings and closer to zero

The bulkiest result of Uruguay Round are the 22,500 pages listing individual countries' commitments on specific categories of goods and services. These include commitments to cut and "bind" their customs duty rates on imports of goods. In some cases, tariffs are being cut to zero - with zero rates also committed in 1997 on information technology products. There is also a significant increase in the number of "bound" tariffs - duty rates that are committed in the WTO and are difficult to raise.

Tariff cuts: Developed countries' tariff cuts are for the most part being phased in over five years from 1 January 1995. The result will be a 40% cut in their tariffs on industrial products, from an average of 6.3% to 3.8%. The value of imported industrial products that receive duty-free treatment in developed countries will jump from 20% to 44%.

There will also be fewer products charged high duty rates. The proportion of imports into developed countries from all sources facing tariffs rates of more than 15% will decline from 7% to 5%. The proportion of developing country exports facing tariffs above 15% in industrial countries will fall from 9% to 5%.

The Uruguay Round package has now been improved. On 26 March 1997, 40 countries accounting for more than 92% of world trade in information technology products, agreed to eliminate import duties and other charges on these products by 2000 (by 2005 in a handful of cases). As with other tariff commitments, each participating country is applying its commitments equally to exports from all WTO members (i.e. on a most-favoured-nation basis), even from members that did not make commitments.

More bindings: Developed countries increased the number of imports whose tariff rates are "bound" (committed and difficult to increase) from 78% of product lines to 99%. For developing countries, the increase was considerable: from 21% to 73%. Economies in transition from central planning increased their bindings from 73% to 98%. This all means a substantially higher degree of market security for traders and investors.

And agriculture...: Tariffs on all agricultural products are now bound. Almost all import restrictions that did not take the form of tariffs, such as quotas, have been converted to tariffs - a process known as "tariffication". This has made markets substantially more predictable for agriculture. Previously more than 30% of agricultural produce had faced quotas or import restrictions. At first, they were converted to tariffs that represented about the same level of protection as the previous restrictions, but over six years these tariffs are gradually being reduced. The market access commitments on agriculture will also eliminate previous import bans on certain products.

The lists also include countries' commitments to reduce domestic support and export subsidies for agricultural products.

Harmonized System (HS)

From the World Customs Organization (WCO) Website

http://www.wcoomd.org/ie/En/Topics_Issues/topics_issues.html

The Harmonized Commodity Description and Coding System, generally referred to as "Harmonized System" or simply "HS", is a multipurpose international product nomenclature developed by the World Customs Organization (WCO). It comprises about 5,000 commodity groups, each identified by a six digit code, arranged in a legal and logical structure and is supported by well-defined rules to achieve uniform classification. The system is used by more than 190 countries and economies as a basis for their Customs tariffs and for the collection of international trade statistics. Over 98 % of the merchandise in international trade is classified in terms of the HS.

The HS contributes to the harmonization of Customs and trade procedures, and the non-documentary trade data interchange in connection with such procedures, thus reducing the costs related to international trade. It is also extensively used by governments, international organizations and the private sector for many other purposes such as internal taxes, trade policies, monitoring of controlled goods, rules of origin, freight tariffs, transport statistics, price monitoring, quota controls, compilation of national accounts, and economic research and analysis. The HS is thus a universal economic language and code for goods, and an indispensable tool for international trade.

The Harmonized System is governed by "The International Convention on the Harmonized Commodity Description and Coding System". The official interpretation of the HS is given in the Explanatory Notes (4 volumes in English and French) published by the WCO. The Explanatory Notes are also available on CD-ROM, as part of a commodity database giving the HS classification of more than 200,000 commodities actually traded internationally.

The maintenance of the HS is a WCO priority. This activity includes measures to secure uniform interpretation of the HS and its periodic updating in light of developments in technology and changes in trade patterns. The WCO manages this process through the Harmonized System Committee (representing the Contracting Parties to the HS Convention), which examines policy matters, takes decisions on classification questions, settles disputes and prepares amendments to the Explanatory Notes. The HS Committee also prepares amendments updating the HS every 4 – 6 years.

Decisions concerning the interpretation and application of the Harmonized System, such as classification decisions and amendments to the Explanatory Notes or to the Compendium of Classification Opinions, become effective two months after the approval by the HS Committee. These are reflected in the amending supplements of the relevant WCO publications and can also be found on this web site.

Specific and Ad Valorem Tariffs / Custom Valuation

From the WTO Website

http://www.wto.org/english/thewto_e/whatis_e/eol/e/wto03/wto3_36.htm#note1

Customs duties can be designated in either specific or ad valorem terms or as a mix of the two. In case of a specific duty, a concrete sum is charged for a quantitative description of the good, for example USD 1 per item or per unit. The customs value of the good does not need to be determined, as the duty is not based on the value of the good but on other criteria. In this case, no rules on customs valuation are needed and the Valuation Agreement does not apply. In contrast, an ad valorem duty depends on the value of a good. Under this system, the customs valuation is multiplied by an ad valorem rate of duty (e.g. 5 per cent) in order to arrive at the amount of duty payable on an imported item.

Customs valuation is a customs procedure applied to determine the customs value of imported goods. If the rate of duty is ad valorem, the customs value is essential to determine the duty to be paid on an imported good.

Article VII of the General Agreement on Tariffs and Trade laid down the general principles for an international system of valuation. It stipulated that the value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values. Although Article VII also contains a definition of "actual value", it still permitted the use of widely differing methods of valuing goods. In addition, 'grandfather clauses' permitted continuation of old standards which did not even meet the very general new standard.

1-2. LAN CASE

This dispute deals with the correct interpretation of a negotiated tariff concession. Consider the reasons why the Appellate Body reversed the panel's findings also from the perspective of the substantive merits of the panel's result. Note also the procedural situation at the end of this dispute.

Summary of Facts

from Case Note by Joel P. Trachtman, (<http://www.ejil.org/journal/Vol9/No2/sr5.html>)

This decision concerns the tariff treatment of local area network ("LAN") equipment and personal computers with multimedia capability ("PCs with multimedia capability"). At the core of this dispute was the question of whether LAN equipment fell under heading 84.71 of the European Communities ("EC") tariff schedule, relating to automatic data processing machines and units thereof ("ADP machines"), or whether, as the EC argued, this equipment was properly included under heading 85.17, relating to telecommunications equipment. Customs duties are generally higher on the latter. Indeed, this case explores the intersection between computation and communication.

(...)

The U.S. complaint argued that from June 1995, pursuant to an EC Commission regulation, certain EC customs authorities (notably the British and Irish) changed their tariff treatment of imports of LAN equipment, previously dutiable under heading 84.71 as ADP machines, to rates applicable to heading 85.17, referring to telecommunications equipment. In addition, the U.S. argued that customs authorities had increased tariffs on certain PCs with multimedia capability from heading 84.71 to other categories bearing higher duties.

Report of the Appellate Body

Appellate Body Division: Beeby, Ehlermann and Lacarte-Muró

http://www.wto.org/english/tratop_e/dispu_e/distab_e.htm

**WORLD TRADE
ORGANIZATION**

**WT/DS62/AB/R
WT/DS67/AB/R
WT/DS68/AB/R
5 June 1998
(98-2271)**

Appellate Body

**EUROPEAN COMMUNITIES - CUSTOMS CLASSIFICATION
OF CERTAIN COMPUTER EQUIPMENT**

AB-1998-2

Report of the Appellate Body

I. Introduction

1. The European Communities appeals from certain issues of law covered in the Panel Report, *European Communities - Customs Classification of Certain Computer Equipment*¹ (the "Panel Report") and certain legal interpretations developed by the Panel in that Report. The Panel was established to consider complaints by the United States against the European Communities, Ireland and the United Kingdom concerning the tariff treatment of Local Area Network ("LAN") equipment and personal computers with multimedia capability ("PCs with multimedia capability").² The United States claimed that the European Communities, Ireland and the United Kingdom accorded to LAN equipment and/or PCs with multimedia capability treatment less favourable than that provided for in Schedule LXXX of the European Communities³ ("Schedule LXXX") and, therefore, acted inconsistently with their obligations under Article II:1 of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994").

2. The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 5 February 1998. The Panel reached the conclusion that:

... the European Communities, by failing to accord imports of LAN equipment from the United States treatment no less favourable than that provided for under heading 84.71 or heading 84.73, as the case may be, in Part I of Schedule LXXX, acted inconsistently with the requirements of Article II:1 of GATT 1994.⁴

The Panel made the following recommendation:

The Panel recommends that the Dispute Settlement Body request the European Communities to bring its tariff treatment of LAN equipment into conformity with its obligations under GATT 1994.⁵

¹WT/DS62/R, WT/DS67/R and WT/DS68/R, 5 February 1998.

²The United States submitted three requests for the establishment of a panel: *European Communities - Customs Classification of Certain Computer Equipment*, WT/DS62/4, 13 February 1997; *United Kingdom - Customs Classification of Certain Computer Equipment*, WT/DS67/3, 10 March 1997; and *Ireland - Customs Classification of Certain Computer Equipment*, WT/DS68/2, 10 March 1997. At its meeting of 20 March 1997, the Dispute Settlement Body (the "DSB") agreed to modify, at the request of the parties to the dispute, the terms of reference of the Panel established against the European Communities, so that the panel requests by the United States contained in documents WT/DS67/3 and WT/DS68/2 might be incorporated into the mandate of the Panel established pursuant to document WT/DS62/4. See WT/DS62/5, 25 April 1997.

³Schedule LXXX of the European Communities, *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, done at Marrakesh, 15 April 1994.

⁴Panel Report, para. 9.1.

⁵Panel Report, para. 9.2.

3. On 24 March 1998, the European Communities notified the DSB⁶ of its intention to appeal certain issues of law covered in the Panel Report and legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal with the Appellate Body, pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). On 3 April 1998, the European Communities filed an appellant's submission.⁷ On 20 April 1998, the United States filed an appellee's submission⁸ and on the same day, Japan filed a third participant's submission.⁹ The oral hearing, provided for in Rule 27 of the *Working Procedures*, was held on 27 April 1998. At the oral hearing, the participants and the third participant presented their arguments and answered questions from the Division of the Appellate Body hearing the appeal.

(...)

III. Issues Raised in this Appeal

57. The appellant, the European Communities, raises the following issues in this appeal:

(...)

- (b) Whether the Panel erred in interpreting Schedule LXXX, in particular, by reading Schedule LXXX in the light of the "legitimate expectations" of an exporting Member, and by considering that Article II:5 of the GATT 1994 confirms the interpretative value of "legitimate expectations"; and
- (c) Whether the Panel erred in putting the onus of clarifying the scope of a tariff concession during a multilateral tariff negotiation conducted under the auspices of the GATT/WTO, solely on the importing Member.

(...)

V. "Legitimate Expectations" in the Interpretation of a Schedule

74. The European Communities also submits that the Panel erred in interpreting Schedule LXXX, in particular, by:

- (a) reading Schedule LXXX in the light of the "legitimate expectations" of an exporting Member; and

⁶WT/DS62/8, WT/DS67/6 and WT/DS68/5, 24 March 1998.

⁷Pursuant to Rule 21(1) of the *Working Procedures*.

⁸Pursuant to Rule 22 of the *Working Procedures*.

⁹Pursuant to Rule 24 of the *Working Procedures*.

- (b) considering that Article II:5 of the GATT 1994 confirms the interpretative value of "legitimate expectations".

Subordinately, the European Communities submits that the Panel erred in considering that the "legitimate expectations" of an exporting Member with regard to the interpretation of tariff concessions should be based on the classification practices for individual importers and individual consignments, or on the subjective perception of a number of exporting companies of that exporting Member.

75. Schedule LXXX provides tariff concessions for ADP machines under headings 84.71 and 84.73 and for telecommunications equipment under heading 85.17. The customs duties set forth in Schedule LXXX on telecommunications equipment are generally higher than those on ADP machines.¹⁰ We note that Schedule LXXX does not contain any explicit reference to "LAN equipment" and that the European Communities currently treats LAN equipment as telecommunications equipment. The United States, however, considers that the EC tariff concessions on ADP machines, and not its tariff concessions on telecommunications equipment, apply to LAN equipment. The United States claimed before the Panel, therefore, that the European Communities accords to imports of LAN equipment treatment less favourable than that provided for in its Schedule, and thus has acted inconsistently with Article II:1 of the GATT 1994. The United States argued that the treatment provided for by a concession is the treatment reasonably expected by the trading partners of the Member which made the concession.¹¹ On the basis of the negotiating history of the Uruguay Round tariff negotiations and the actual tariff treatment accorded to LAN equipment by customs authorities in the European Communities during these negotiations, the United States argued that it reasonably expected the European Communities to treat LAN equipment as ADP machines, not as telecommunications equipment.

76. The Panel found that:

... for the purposes of Article II:1, it is impossible to determine whether LAN equipment should be regarded as an ADP machine purely on the basis of the ordinary meaning of the terms used in Schedule LXXX taken in isolation. However, as noted above, the meaning of the term "ADP machines" in this context may be determined in light of the legitimate expectations of an exporting Member.¹²

77. In support of this finding, the Panel explained that:

¹⁰See Panel Report, paras. 2.10 and 8.1.

¹¹See Panel Report, para. 5.15.

¹²Panel Report, para. 8.31.

The meaning of a particular expression in a tariff schedule cannot be determined in isolation from its context. It has to be interpreted in the context of Article II of GATT 1994 ... It should be noted in this regard that the protection of legitimate expectations in respect of tariff treatment of a bound item is one of the most important functions of Article II.¹³

The Panel justified this latter statement by relying on the panel report in *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*¹⁴ ("*EEC - Oilseeds*"), and stated that:

The fact that the *Oilseeds* panel report concerns a non-violation complaint does not affect the validity of this reasoning in cases where an actual violation of tariff commitments is alleged. If anything, such a direct violation would involve a situation where expectations concerning tariff concessions were even more firmly grounded.¹⁵

78. The Panel also relied on Article II:5 of the GATT 1994, and stated that:

Although Article II:5 is a provision for the special bilateral procedure regarding tariff classification, not directly at issue in this case, the existence of this provision confirms that legitimate expectations are a vital element in the interpretation of Article II and tariff schedules.¹⁶

79. Finally, the Panel observed that its proposition that the terms of a Member's Schedule may be determined in the light of the "legitimate expectations" of an exporting Member:

... is also supported by the object and purpose of the WTO Agreement and those of GATT 1994. The security and predictability of "the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade" (expression common in the preambles to the two agreements) cannot be maintained without protection of such legitimate expectations. This is consistent with the principle of good faith interpretation under Article 31 of the Vienna Convention.¹⁷

80. We disagree with the Panel's conclusion that the meaning of a tariff concession in a Member's Schedule may be determined in the light of the "legitimate expectations" of an exporting Member. First, we fail to see the relevance of the *EEC - Oilseeds* panel report with respect to the

¹³Panel Report, para. 8.23.

¹⁴Adopted 25 January 1990, BISD 37S/86, para. 148.

¹⁵Panel Report, para. 8.23.

¹⁶Panel Report, para. 8.24.

¹⁷Panel Report, para. 8.25.

interpretation of a Member's Schedule in the context of a violation complaint made under Article XXIII:1(a) of the GATT 1994. The *EEC - Oilseeds* panel report dealt with a non-violation complaint under Article XXIII:1(b) of the GATT 1994, and is not legally relevant to the case before us. Article XXIII:1 of the GATT 1994 provides for three legally-distinct causes of action on which a Member may base a complaint; it distinguishes between so-called *violation* complaints, *non-violation* complaints and *situation* complaints under paragraphs (a), (b) and (c). The concept of "reasonable expectations", which the Panel refers to as "legitimate expectations", is a concept that was developed in the context of *non-violation* complaints.¹⁸ As we stated in *India - Patents*, for the Panel to use this concept in the context of a violation complaint "melds the legally-distinct bases for 'violation' and 'non-violation' complaints under Article XXIII of the GATT 1994 into one uniform cause of action"¹⁹, and is not in accordance with established GATT practice.

81. Second, we reject the Panel's view that Article II:5 of the GATT 1994 confirms that "legitimate expectations are a vital element in the interpretation" of Article II:1 of the GATT 1994 and of Members' Schedules.²⁰ It is clear from the wording of Article II:5 that it does not support the Panel's view. This paragraph recognizes the possibility that the treatment *contemplated* in a concession, provided for in a Member's Schedule, on a particular product, may differ from the treatment *accorded* to that product and provides for a compensatory mechanism to rebalance the concessions between the two Members concerned in such a situation. However, nothing in Article II:5 suggests that the expectations of *only* the exporting Member can be the basis for interpreting a concession in a Member's Schedule for the purposes of determining whether that Member has acted consistently with its obligations under Article II:1. In discussing Article II:5, the Panel overlooked the second sentence of that provision, which clarifies that the "contemplated treatment" referred to in that provision is the treatment contemplated by *both* Members.

82. Third, we agree with the Panel that the security and predictability of "the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade" is an object and purpose of the *WTO Agreement*, generally, as well as of the GATT 1994.²¹ However, we disagree with the Panel that the maintenance of the security and predictability of tariff concessions allows the interpretation of a concession in the light of the "legitimate expectations" of exporting Members, i.e., their *subjective* views as to what the agreement reached during tariff negotiations was. The security and predictability of tariff concessions would be seriously undermined if the concessions in Members' Schedules were to be interpreted on the basis of the subjective views of certain exporting Members alone. Article II:1 of the GATT 1994 ensures the maintenance of the security and predictability of tariff concessions by requiring that Members not accord treatment less favourable to the commerce of *other* Members than that provided for in their Schedules.

83. Furthermore, we do not agree with the Panel that interpreting the meaning of a concession in a Member's Schedule in the light of the "legitimate expectations" of exporting Members is consistent with the principle of good faith interpretation under Article 31 of the *Vienna Convention*. Recently, in *India - Patents*, the panel stated that good faith interpretation under

¹⁸See Appellate Body Report, *India - Patents*, adopted 16 January 1998, WT/DS50/AB/R, paras. 36 and 41.

¹⁹Adopted 16 January 1998, WT/DS50/AB/R, para. 42.

²⁰See Panel Report, para. 8.24.

²¹See Panel Report, para. 8.25.

Article 31 required "the protection of legitimate expectations".²² We found that the panel had misapplied Article 31 of the *Vienna Convention* and stated that:

The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties. This should be done in accordance with the principles of treaty interpretation set out in Article 31 of the *Vienna Convention*. But these principles of interpretation neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended.²³

84. The purpose of treaty interpretation under Article 31 of the *Vienna Convention* is to ascertain the *common* intentions of the parties. These *common* intentions cannot be ascertained on the basis of the subjective and unilaterally determined "expectations" of *one* of the parties to a treaty. Tariff concessions provided for in a Member's Schedule -- the interpretation of which is at issue here -- are reciprocal and result from a mutually-advantageous negotiation between importing and exporting Members. A Schedule is made an integral part of the GATT 1994 by Article II:7 of the GATT 1994. Therefore, the concessions provided for in that Schedule are part of the terms of the treaty. As such, the only rules which may be applied in interpreting the meaning of a concession are the general rules of treaty interpretation set out in the *Vienna Convention*.

85. Pursuant to Article 31(1) of the *Vienna Convention*, the meaning of a term of a treaty is to be determined in accordance with the ordinary meaning to be given to this term in its context and in the light of the object and purpose of the treaty. Article 31(2) of the *Vienna Convention* stipulates that:

The context, for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

- (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
- (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

Furthermore, Article 31(3) provides that:

There shall be taken into account together with the context:

- (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

²²Panel Report, *India - Patents*, adopted 16 January 1998, WT/DS50/R, para. 7.18.

²³Appellate Body Report, *India - Patents*, adopted 16 January 1998, WT/DS50/AB/R, para. 45.

- (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
- (c) any relevant rules of international law applicable in the relations between the parties.

Finally, Article 31(4) of the *Vienna Convention* stipulates that:

A special meaning shall be given to a term if it is established that the parties so intended.

86. The application of these rules in Article 31 of the *Vienna Convention* will usually allow a treaty interpreter to establish the meaning of a term.²⁴ However, if after applying Article 31 the meaning of the term remains ambiguous or obscure, or leads to a result which is manifestly absurd or unreasonable, Article 32 allows a treaty interpreter to have recourse to:

... supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion.

With regard to "the circumstances of [the] conclusion" of a treaty, this permits, in appropriate cases, the examination of the historical background against which the treaty was negotiated.²⁵

87. In paragraphs 8.20 and 8.21 of the Panel Report, the Panel quoted Articles 31 and 32 of the *Vienna Convention* and explicitly recognized that these fundamental rules of treaty interpretation applied "in determining whether the tariff treatment of LAN equipment ... is in conformity with the tariff commitments contained in Schedule LXXX".²⁶ As we have already noted above, the Panel, after a textual analysis²⁷, came to the conclusion that:

... for the purposes of Article II:1, it is impossible to determine whether LAN equipment should be regarded as an ADP machine purely on the basis of the ordinary meaning of the terms used in Schedule LXXX taken in isolation.²⁸

²⁴R. Jennings and A. Watts (eds.), *Oppenheim's International Law*, 9th ed., Vol. I (Longman, 1992), p. 1275.

²⁵I. Sinclair, *The Vienna Convention on the Law of Treaties*, 2nd ed., (Manchester University Press, 1984), p. 141:

... the reference in Article 32 of the Convention to the circumstances of the conclusion of a treaty may have some value in emphasising the need for the interpreter to bear constantly in mind the historical background against which the treaty has been negotiated.

²⁶Panel Report, para. 8.22.

²⁷See Panel Report, para. 8.30.

²⁸Panel Report, para. 8.31.

Subsequently, the Panel abandoned its effort to interpret the terms of Schedule LXXX in accordance with Articles 31 and 32 of the *Vienna Convention*.²⁹ In doing this, the Panel erred.

88. As already discussed above, the Panel referred to the *context* of Schedule LXXX³⁰ as well as to the *object and purpose* of the *WTO Agreement* and the GATT 1994, of which Schedule LXXX is an integral part.³¹ However, it did so to support its proposition that the terms of a Schedule may be interpreted in the light of the "legitimate expectations" of an exporting Member. The Panel failed to examine the context of Schedule LXXX and the object and purpose of the *WTO Agreement* and the GATT 1994 in accordance with the rules of treaty interpretation set out in the *Vienna Convention*.

89. We are puzzled by the fact that the Panel, in its effort to interpret the terms of Schedule LXXX, did not consider the *Harmonized System* and its *Explanatory Notes*. We note that during the Uruguay Round negotiations, both the European Communities and the United States were parties to the *Harmonized System*. Furthermore, it appears to be undisputed that the Uruguay Round tariff negotiations were held on the basis of the *Harmonized System's* nomenclature and that requests for, and offers of, concessions were normally made in terms of this nomenclature. Neither the European Communities nor the United States argued before the Panel³² that the *Harmonized System* and its *Explanatory Notes* were relevant in the interpretation of the terms of Schedule LXXX. We believe, however, that a proper interpretation of Schedule LXXX should have included an examination of the *Harmonized System* and its *Explanatory Notes*.

90. A proper interpretation also would have included an examination of the existence and relevance of subsequent practice. We note that the United States referred, before the Panel, to the decisions taken by the Harmonized System Committee of the WCO in April 1997 on the classification of certain LAN equipment as ADP machines.³³ Singapore, a third party in the panel proceedings, also referred to these decisions.³⁴ The European Communities observed that it had introduced reservations with regard to these decisions and that, even if they were to become final as they stood, they would not affect the outcome of the present dispute for two reasons: first, because these decisions could not confirm that LAN equipment was classified as ADP machines in 1993 and 1994; and, second, because this dispute "was about duty treatment and not about product

²⁹As discussed above in paragraphs 76-84, the Panel relied instead on the concept of "legitimate expectations" as a means of treaty interpretation.

³⁰See Panel Report, paras. 8.23-8.24.

³¹See Panel Report, para. 8.25.

³²We recall, however, that in reply to our questions at the oral hearing, both the European Communities and the United States accepted the relevance of the *Harmonized System* and its *Explanatory Notes* in interpreting the tariff concessions of Schedule LXXX. See paras. 13 and 38 of this Report.

³³See Panel Report, para. 5.12.

³⁴As noted in para. 6.34 of the Panel Report, Singapore pointed out, before the Panel, that:

... the WCO's HS Committee had recently decided that LAN equipment was properly classifiable in heading 84.71 of the HS. The HS Committee had specifically declined to adopt the position advanced that heading 85.17 was the appropriate category ... The EC had suggested that the HS Committee decision was intended solely to establish the appropriate HS classification for future imports. It ignored that the language interpreted by the HS Committee was the same language appearing in the EC's HS nomenclature and in the EC's concession schedule at the time of the negotiations and afterwards.

classification".³⁵ We note that the United States agrees with the European Communities that this dispute is not a dispute on the *correct* classification of LAN equipment, but a dispute on whether the tariff treatment accorded to LAN equipment was less favourable than that provided for in Schedule LXXX.³⁶ However, we consider that in interpreting the tariff concessions in Schedule LXXX, decisions of the WCO may be relevant; and, therefore, they should have been examined by the Panel.

91. We note that the European Communities stated that the question whether LAN equipment was bound as ADP machines, under headings 84.71 and 84.73, or as telecommunications equipment, under heading 85.17, was *not* addressed during the Uruguay Round tariff negotiations with the United States.³⁷ We also note that the United States asserted that:

In many, perhaps most, cases, the detailed product composition of tariff commitments was *never* discussed in detail during the tariff negotiations of the Uruguay Round ...³⁸ (emphasis added)

and that:

The US-EC negotiation on Chapter 84 provided an example of how two groups of busy negotiators dealing with billions of dollars of trade and hundreds of tariff lines relied on *a continuation of the status quo*.³⁹ (emphasis added)

This may well be correct and, in any case, seems central to the position of the United States. Therefore, we are surprised that the Panel did not examine whether, during the Tokyo Round tariff negotiations, the European Communities bound LAN equipment as ADP machines or as telecommunications equipment.⁴⁰

92. Albeit, with the mistaken aim of establishing whether the United States "was entitled to legitimate expectations"⁴¹ regarding the tariff treatment of LAN equipment by the European Communities, the Panel examined, in paragraphs 8.35 to 8.44 of the Panel Report, the classification practice regarding LAN equipment in the European Communities during the Uruguay Round tariff negotiations. The Panel did this on the basis of certain BTIs and other decisions relating to the customs classification of LAN equipment, issued by customs authorities in the European Communities during the Uruguay Round.⁴² In the light of our observations on "the circumstances of [the] conclusion" of a treaty as a supplementary means of interpretation under

³⁵Panel Report, para. 5.13.

³⁶See Panel Report, para. 5.3.

³⁷See Panel Report, para. 5.28.

³⁸Appellee's submission of the United States, para. 26.

³⁹Panel Report, para. 5.31.

⁴⁰We note that in paragraph 8 of its third participant's submission, Japan stated that: "[i]n particular, the classification of the LAN equipment among the Members of the EC was not identical before the Uruguay Round".

⁴¹Panel Report, para. 8.60.

⁴²The lists of the BTIs and classification decisions in the form of a letter, submitted by the parties and considered by the Panel, were attached to the Panel Report as Annex 4 and Annex 6 thereof.

Article 32 of the *Vienna Convention*⁴³, we consider that the classification practice in the European Communities during the Uruguay Round is part of "the circumstances of [the] conclusion" of the *WTO Agreement* and may be used as a supplementary means of interpretation within the meaning of Article 32 of the *Vienna Convention*. However, two important observations must be made: first, the Panel did *not* examine the classification practice in the European Communities during the Uruguay Round negotiations *as a supplementary means of interpretation* within the meaning of Article 32 of the *Vienna Convention*⁴⁴; and, second, the value of the classification practice as a supplementary means of interpretation is subject to certain qualifications discussed below.

93. We note that the Panel examined the classification practice of only the European Communities⁴⁵, and found that the classification of LAN equipment by the United States during the Uruguay Round tariff negotiations was not relevant.⁴⁶ The purpose of treaty interpretation is to establish the *common* intention of the parties to the treaty. To establish this intention, the prior practice of only *one* of the parties may be relevant, but it is clearly of more limited value than the practice of all parties. In the specific case of the interpretation of a tariff concession in a Schedule, the classification practice of the importing Member, in fact, may be of great importance. However, the Panel was mistaken in finding that the classification practice of the United States was *not* relevant.

94. In this context, we also note that while the Panel examined the classification practice during the Uruguay Round negotiations, it did not consider the EC legislation on customs classification of goods that was applicable at that time. In particular, it did not consider the "General Rules for the Interpretation of the Combined Nomenclature" as set out in Council Regulation 2658/87 on the Common Customs Tariff.⁴⁷ If the classification practice of the importing Member at the time of the tariff negotiations is relevant in interpreting tariff concessions in a Member's Schedule, surely that Member's legislation on customs classification at that time is also relevant.

95. Then there is the question of the *consistency* of prior practice. Consistent prior classification practice may often be significant. Inconsistent classification practice, however, *cannot* be relevant in interpreting the meaning of a tariff concession. We note that the Panel, on the basis of evidence relating to *only* five out of the then 12 Member States⁴⁸, made the following factual findings with regard to the classification practice in the European Communities:

⁴³See para. 86 of this Report.

⁴⁴It examined the actual classification practice to determine whether the United States could have "legitimate expectations" with regard to the tariff treatment of LAN equipment.

⁴⁵See Panel Report, paras. 8.36-8.44.

⁴⁶See Panel Report, para. 8.60. We note that in paragraph 8.58 of the Panel Report, the Panel stated that the classification of LAN equipment by other WTO Members was not relevant either.

⁴⁷Title I, Part I of Annex I of Council Regulation (EEC) No. 2658/87 of 23 July 1987, Official Journal No. L 256, 7 September 1987, p. 1.

⁴⁸With regard to the manner in which the Panel evaluated the evidence regarding classification practice during the Uruguay Round tariff negotiations, we note that in paragraph 8.37 of the Panel Report, the Panel accepted certain BTIs submitted by the United States as relevant evidence, while in footnote 152 of the Panel Report, it considered similar BTIs submitted by the European Communities to be irrelevant.

To rebut the presumption raised by the United States, the European Communities has produced documents which *indicate* that LAN equipment had been treated as telecommunication apparatus by other customs authorities in the European Communities.⁴⁹ (emphasis added)

... it would be reasonable to conclude at least that the practice [regarding classification of LAN equipment] was not uniform in France during the Uruguay Round.⁵⁰

Germany appears to have consistently treated LAN equipment as telecommunication apparatus.⁵¹

... LAN equipment was *generally* treated as ADP machines in Ireland and the United Kingdom during the Uruguay Round.⁵² (emphasis added)

As a matter of logic, these factual findings of the Panel lead to the conclusion that, during the Uruguay Round tariff negotiations, the practice regarding the classification of LAN equipment by customs authorities throughout the European Communities was *not* consistent.

96. We also note that in paragraphs 8.44 and 8.60 of the Panel Report, the Panel identified Ireland and the United Kingdom as the "largest" and "major" market for LAN equipment exported from the United States. On the basis of this assumption, the Panel gave special importance to the classification practice by customs authorities in these two Member States. However, the European Communities constitutes a customs union, and as such, once goods are imported into any Member State, they circulate freely within the territory of the entire customs union. The export market, therefore, is the European Communities, not an individual Member State.

97. For the reasons set out above, we conclude that the Panel erred in finding that the "legitimate expectations" of an exporting Member are relevant for the purposes of interpreting the terms of Schedule LXXX and of determining whether the European Communities violated Article II:1 of the GATT 1994. We also conclude that the Panel misinterpreted Article II:5 of the GATT 1994.

⁴⁹Panel Report, para. 8.40.

⁵⁰Panel Report, para. 8.42.

⁵¹Panel Report, para. 8.43.

⁵²Panel Report, para. 8.41. In this paragraph, the Panel stated that the only direct counter-evidence against the claim of the United States that customs authorities in Ireland and the United Kingdom consistently classified LAN equipment as ADP machines during the Uruguay Round negotiations is a BTI issued by the UK customs authority to CISCO, classifying one type of LAN equipment (routers) as telecommunications apparatus. The Panel dismisses the value of this BTI as evidence on the basis that it "became effective only a week or so before the conclusion of the Uruguay Round negotiations [15 December 1993]". Similarly, in footnote 152 of the Panel Report, the Panel did not consider other BTIs issued by the UK customs authorities to be relevant because they became valid after the conclusion of the Uruguay Round negotiations. We note, however, that all of these BTIs became valid in December 1993 or February 1994, i.e., before the end of the verification process, to which all Schedules were submitted and which took place between 15 February 1994 and 25 March 1994 (MTN.TNC/W/131, 21 January 1994). Therefore, in our view, the Panel should have considered these BTIs.

98. On the basis of the erroneous legal reasoning developed and the selective evidence considered, the Panel was not justified in coming to the conclusion that the United States was entitled to "legitimate expectations" that LAN equipment would be accorded tariff treatment as ADP machines in the European Communities⁵³ and, therefore, that the European Communities acted inconsistently with the requirements of Article II:1 of the GATT 1994 by failing to accord imports of LAN equipment from the United States treatment no less favourable than that provided for in Schedule LXXX.⁵⁴

99. In the light of our conclusion that the "legitimate expectations" of an exporting Member are not relevant in determining whether the European Communities violated Article II:1 of the GATT 1994, we see no reason to examine the subordinate claim of error of the European Communities relating to the evidence on which the "legitimate expectations" of exporting Members were based.

VI. Clarification of the Scope of Tariff Concessions

100. The last issue raised by the European Communities in this appeal is whether the Panel erred in placing the onus of clarifying the scope of a tariff concession during a multilateral tariff negotiation, held under the auspices of the GATT/WTO, solely on the importing Member.

101. In paragraph 8.60 of the Panel Report, the Panel concluded that:

We find that the United States was entitled to legitimate expectations that LAN equipment would continue to be accorded tariff treatment as ADP machines in the European Communities, based on the actual tariff treatment during the Uruguay Round, particularly in Ireland and the United Kingdom ... We further find that the United States was not required to *clarify the scope* of the European Communities' *tariff concessions* on LAN equipment ... (emphasis added)

Prior to this conclusion, the Panel stated the following:

... we find that the European Communities cannot place the burden of clarification on the United States in cases where it has created, through its own practice, the expectations regarding the continuation of the actual tariff treatment prevailing at the time of the tariff negotiations. It would not be reasonable to expect the US Government to seek clarification when it had not heard any complaints from its exporters, who were apparently satisfied with

⁵³See Panel Report, para. 8.60.

⁵⁴See Panel Report, para. 9.1.

the current tariff treatment of LAN equipment in their major export market -- Ireland and the United Kingdom.⁵⁵

102. The European Communities appeals these findings, and argues that:

... the Panel erred where it considered that, in any case, the onus of clarifying the scope of a tariff concession during a multilateral tariff negotiation ... shall necessarily be put on the side of the importing Member. By doing so, the Panel has created and applied a new rule on the burden of proof in the dispute settlement procedure which is outside its terms of reference and is beyond the powers of a panel.⁵⁶

103. We do not agree that the Panel has created and applied a new rule on the burden of proof. The rules on the burden of proof are those which we clarified in *United States - Shirts and Blouses*.⁵⁷

104. The Panel's findings in paragraphs 8.55 and 8.60 on the "requirement of clarification" are linked to the Panel's reliance on "legitimate expectations" as a means of interpretation of the tariff concessions in Schedule LXXX. They serve to complete and buttress the Panel's conclusion that "the United States was entitled to legitimate expectations that LAN equipment would continue to be accorded tariff treatment as ADP machines in the European Communities".⁵⁸

105. We note that the Panel's findings in paragraphs 8.55 and 8.60 on the "requirement of clarification" were, in fact, the Panel's response to the question whether:

... the exporting Member has any inherent obligation to seek clarification when it has been otherwise given a basis to expect that actual tariff treatment by the importing Member will be maintained.⁵⁹

⁵⁵Panel Report, para. 8.55.

⁵⁶Notice of Appeal of the European Communities, para. 4.

⁵⁷Adopted 23 May 1997, WT/DS33/AB/R, p. 14. See also, Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, adopted 13 February 1998, WT/DS26/AB/R, WT/DS48/AB/R, paras. 97-109.

⁵⁸Panel Report, para. 8.60.

⁵⁹Panel Report, para. 8.48.

106. We also note the Panel's references⁶⁰ to the panel report in *Panel on Newsprint* and the report by the Group of Experts in *Greek Increase in Bound Duty*.⁶¹ In both of these reports, the conclusions on the obligations of the importing contracting party under Article II:1 of the GATT 1994 were reached on the basis of the ordinary meaning of the wording of the respective Schedules. These reports also assume that the tariff concessions made by the importing contracting party would have had to be limited by "conditions or qualifications" if they were to be interpreted restrictively. That the Panel reads these two reports in this way is evident from the Panel's concluding remark that "these cases ... confirm that the onus of clarifying tariff *commitment* is generally placed on the importing Member" (emphasis added).⁶²

107. However, the case before us raises a different problem. The question here is whether the European Communities has committed itself to treat LAN equipment as ADP machines under headings 84.71 or 84.73, rather than as telecommunications equipment under heading 85.17 of Schedule LXXX. We do not believe that the "requirement of clarification", as discussed by the Panel, is relevant to this question.

108. The Panel also based its conclusions on the "requirement of clarification" on a certain perception of the nature of tariff commitments. The Panel stated:

... that a tariff commitment is an instrument in the hands of an importing Member which inherently serves the importing Member's "protection needs and its requirements for the purposes of tariff and trade negotiations". ... It is for this reason that it behooves the importing party, as the effective bearer of its rights and responsibilities, to correctly identify products and relevant duties in its tariff schedules, including such limitations or modifications as it intends to apply.⁶³

109. We do not share this perception of the nature of tariff commitments. Tariff negotiations are a process of reciprocal demands and concessions, of "give and take". It is only normal that importing Members define their offers (and their ensuing obligations) in terms which suit their needs. On the other hand, exporting Members have to ensure that their corresponding rights are described in such a manner in the Schedules of importing Members that their export interests, as agreed in the negotiations, are guaranteed. There was a special arrangement made for this in the Uruguay Round. For this purpose, a process of verification of tariff schedules took place from 15 February through 25 March 1994, which allowed Uruguay Round participants to check and control, through consultations with their negotiating partners, the scope and definition of tariff concessions.⁶⁴ Indeed, the fact that Members' Schedules are an integral part of the GATT 1994

⁶⁰See Panel Report, paras. 8.51-8.54.

⁶¹L/580, 9 November 1956. We note that while the panel report in *Panel on Newsprint* was adopted by the CONTRACTING PARTIES, the report by the Group of Experts in *Greek Increase in Bound Duty* was not.

⁶²Panel Report, para. 8.54.

⁶³Panel Report, para. 8.50.

⁶⁴MTN.TNC/W/131, 21 January 1994. See also *Marrakesh Protocol to the General Agreement on Tariffs*

indicates that, while each Schedule represents the tariff commitments made by *one* Member, they represent a common agreement among *all* Members.

110. For the reasons stated above, we conclude that the Panel erred in finding that "the United States was not required to clarify the scope of the European Communities' tariff concessions on LAN equipment".⁶⁵ We consider that any clarification of the scope of tariff concessions that may be required during the negotiations is a task for *all* interested parties.

VII. Conclusions

111. For the reasons set out in this Report, the Appellate Body:

- (a) upholds the finding of the Panel that the request of the United States for the establishment of a panel met the requirements of Article 6.2 of the DSU;
- (b) reverses the findings of the Panel that the United States was entitled to "legitimate expectations" that LAN equipment would be accorded tariff treatment as ADP machines in the European Communities and, therefore, that the European Communities acted inconsistently with the requirements of Article II:1 of the GATT 1994 by failing to accord imports of LAN equipment from the United States treatment no less favourable than that provided for in Schedule LXXX; and
- (c) reverses the ancillary finding of the Panel that the United States was not required to clarify the scope of the European Communities' tariff concessions on LAN equipment.

Signed in the original at Geneva this 19th day of May 1998 by:

Christopher Beeby
Presiding Member

Claus-Dieter Ehlermann
Member

Julio Lacarte-Muró
Member

and Trade 1994, para. 3.

⁶⁵Panel Report, para. 8.60.

Case Note (LAN)

<http://www.ejil.org/journal/Vol9/No2/sr5.html>

European Communities--Customs Classification of Certain Computer Equipment

Joel P. Trachtman

WTO Appellate Body Report:

European Communities--Customs Classification of Certain Computer Equipment,
AB-1998-2, WT/DS62, 67, 68/AB/R (98-2271),

adopted by Dispute Settlement Body, [not yet adopted as of 30 June 1998].

European Communities, Appellant; United States, Appellee; Japan, Third Participant.

Division: Beeby, Ehlermann and Lacarte-Muró.

Major Topics Addressed by Appellate Body: Specificity of Notice under Article 6.2 of the DSU; Interpretation of Tariff Schedules.

Abstract

This decision concerns the tariff treatment of local area network (“LAN”) equipment and personal computers with multimedia capability (“PCs with multimedia capability”). At the core of this dispute was the question of whether LAN equipment fell under heading 84.71 of the European Communities (“EC”) tariff schedule, relating to automatic data processing machines and units thereof (“ADP machines”), or whether, as the EC argued, this equipment was properly included under heading 85.17, relating to telecommunications equipment. Customs duties are generally higher on the latter. Indeed, this case explores the intersection between computation and communication.

The Panel allocated the burden of clarification of these tariff categories to the importing state--the EC--and considered the exporting state’s unilateral “legitimate expectations” as a guide to interpretation. The Appellate Body rejected these decisions, determining that all parties share responsibility for clarification of WTO treaty rules, and that the Vienna Convention does not support a reference to only one side’s “legitimate expectations.” However, the Appellate Body decision is troubling for several reasons, not the least of which is that the Appellate Body, having rejected the Panel’s analysis, did not seem to engage in a complete interpretative analysis of its own.

Facts

The U.S. complaint argued that from June 1995, pursuant to an EC Commission regulation, certain EC customs authorities (notably the British and Irish) changed their tariff treatment of imports of LAN equipment, previously dutiable under heading 84.71 as ADP machines, to rates applicable to heading 85.17, referring to telecommunications equipment. In addition, the U.S. argued that customs authorities had increased tariffs on certain PCs with multimedia capability from heading 84.71 to other categories bearing higher duties.

Analysis of the Panel Report

Specificity of Notice under Article 6.2 of the DSU

The EC raised a procedural objection to the U.S. complaint, arguing that the U.S. had failed adequately to define the products subject to its complaint, thereby depriving the EC of adequate notice and opportunity to defend.⁶⁶ However, the Panel found the U.S. had provided sufficiently specific notice of the product coverage of its claims, satisfying the requirements of art. 6.2 of the Dispute Settlement Understanding (“DSU”).

Interpretation of Tariff Schedule

The Panel sought to determine whether LAN equipment falls under tariff heading 84.71 or 85.17. It found that it could not “determine whether LAN equipment should be treated as an ADP machine purely on the basis of the ordinary meaning of the terms used in the” EC schedule of concessions.⁶⁷ However, it found that “the term ‘ADP machines’ in this context may be determined in light of the legitimate expectations of an exporting Member.”⁶⁸ In circular terms, the Panel argued that because the protection of legitimate expectations is one of the “most important functions” of article II of GATT, the meaning of this term may be determined on the basis of evidence of “legitimate” expectations. The Panel referred to GATT jurisprudence, as well as article 31 of the Vienna Convention⁶⁹ --requiring interpretation in accordance with the principle of good faith--to support its conclusion. The Panel relied on the GATT panel report, *European Economic Community--Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* (“Oilseeds”),⁷⁰ to support the role of “legitimate expectations.” It will be recalled that the Oilseeds case related to non-violation nullification and impairment.

The Panel first examined the evidence brought by the U.S. of tariff treatment of LAN equipment prior to the conclusion of the Uruguay Round, as well as after. The Panel stated that “an exporting Member's legitimate expectations regarding tariff commitments are normally based, at a minimum, on the assumption that the actual tariff treatment accorded to a particular product at the time of the negotiation will be continued unless such treatment is manifestly anomalous or there is information readily available to the exporting Member that clearly indicates the contrary.”⁷¹ The Panel determined that the prevailing practice during the Uruguay Round (Germany being the only exception) was to treat LAN equipment as ADP machines, forming a basis for the legitimacy of the U.S. expectations. The Panel determined that the EC did not rebut the U.S. assertion of its legitimate expectations.

Burden of Clarification

The Panel cited the *Greek Increase in Bound Duties (Gramophone Records)* working party report⁷² for the proposition that the exporting state may generally rely on consistent tariff classification treatment, and the importing state bears the burden of clarification.

⁶⁶ The EC cited *EEC--Quantitative Restrictions against Imports of Certain Products from Hong Kong*, adopted 12 July 1983, BISD 30S/129, para. 30. In that decision, the panel limited the ability of the complainant to add product categories after the initiation of proceedings. The Panel distinguished the Hong Kong decision, noting that the U.S. had not added any new product.

⁶⁷ Panel Report, *European Communities--Customs Classification of Certain Computer Equipment*, WT/DS62, 67, 68/R (98-0277), 5 February 1998 [hereinafter, “Panel Report”], para. 8.31. The Panelists were Crawford Falconer, Ernesto de La Guardia and Carlos Antonio da Rocha Paranhos.

⁶⁸ *Id.*

⁶⁹ Vienna Convention on the Law of International Treaties, done at Vienna, 23 May 1969, 1155 UNTS 331 [hereinafter, “Vienna Convention”].

⁷⁰ Adopted 25 January 1990, BISD 37S/86, para. 148.

⁷¹ Panel Report, para. 8.45.

⁷² Report by the Group of Experts on *Greek Increase in Bound Duty*, 9 November 1956, L/58.

Analysis of the Appellate Body Report

The EC raised three issues on appeal. First, as a matter of proper procedure, did the U.S. identify with sufficient specificity under article 6.2 of the DSU the measures of the EC subject to dispute? Second, did the Panel err in interpreting the EC's tariff schedule by reference to "legitimate expectations?" Third, did the Panel err in placing the "burden of clarification" of a tariff concession on the importing state, here the EC?

Specificity of Notice under Article 6.2 of the DSU

The EC had argued that the U.S. had only identified a single specific measure, the relevant EC Commission regulation, as a measure subject to dispute. However, the Appellate Body considered that the term "measures" within the meaning of article 6.2 of the DSU need not only refer to laws, but also could refer to actions, in this case the application of tariffs by national customs authorities. Since the U.S. request for the establishment of a panel specifically referenced the categories of goods to which the allegedly illegal tariffs were applied, the Appellate Body pragmatically agreed with the Panel that the U.S. request was specific enough to satisfy the requirements of article 6.2.

The Appellate Body looked to the purposes of article 6.2: the compliance of the U.S. request must be determined by reference to whether it was specific enough to satisfy these due process purposes.

The Appellate Body looked to whether the lack of precision of the terms used by the U.S. adversely affected the ability of the EC to defend its measures, and found that it did not.⁷³ This was not a situation in which the complaining party was seeking to add a claim.

Interpretation of Tariff Schedule

The Panel had stated that, in light of the indeterminacy of the tariff headings, "the meaning of the term 'ADP machines' in this context may be determined in light of the legitimate expectations of an exporting Member."⁷⁴ This proposition was soundly rejected by the Appellate Body. First, the Appellate Body, referring to the *India-Patents* decision,⁷⁵ insisted on the legal irrelevance of the *Oilseeds* case, on the basis that it was a non-violation case. The Appellate Body states that the concept of "reasonable expectations," which is critical to non-violation complaints, has no relationship to violation complaints, such as this one.⁷⁶

It is not easy to see why this is so. It might alternatively be argued that *a fortiori*, if denial of "reasonable expectations" can form the basis for a complaint where no specific provision of GATT has been violated, they can also be a basis for interpretation of GATT.⁷⁷ This is nothing more than teleological interpretation, which is sanctioned by article 31(1) of the Vienna Convention as a means of determining the terms of the treaty. Furthermore, it might be argued that the Appellate Body's distinction between violation and non-violation complaints lacks a firm basis, especially insofar as article 26 of the DSU actually specifies some distinctions between the two types of complaints, but does not mention the one derived by the Appellate Body.

⁷³ Appellate Body Report, para. 70.

⁷⁴ Panel Report, para. 8.31.

⁷⁵ *India--Patent Protection for Pharmaceutical and Agricultural Products*, adopted 16 January 1998, WT/DS50/AB/R, para. 42.

⁷⁶ Appellate Body Report, para. 80.

⁷⁷ This was the Panel's reasoning. Panel Report, para. 8.23.

In addition, the *India-Patents* decision is somewhat distinct from the present case, as the *India-Patents* decision addressed a context in which article 64.2 of the TRIPS Agreement expressly excluded non-violation complaints during the applicable transition period. No such exclusion applies to the present case. Finally, the Appellate Body in *India-Patents* seems to have approved the consideration of “legitimate expectations” at least in some circumstances: “The legitimate expectations of the parties to a treaty are reflected in the language of the treaty itself. The duty of a treaty interpreter is to examine the words of the treaty to determine the intentions of the parties.”⁷⁸

However, the Appellate Body’s further criticism of the Panel’s approach is stronger: it is wrong to consider *only* the “legitimate expectations” of the exporting state. This seems at best an unfortunate depiction by the Panel of the need to search for the intent of *all* the parties to the treaty.⁷⁹ The Appellate Body concluded that “the Panel erred in finding that ‘legitimate expectations’ of an exporting Member” are relevant” for purposes of interpreting the GATT 1994.⁸⁰ The Appellate Body had recently corrected a similar panel error in the *India-Patents* case.⁸¹ The Appellate Body repeated the obvious: that “[t]he purpose of treaty interpretation under Article 31 of the Vienna Convention is to ascertain the *common* intentions of the parties.”⁸² After this method has failed, Article 32 permits reference to supplementary means, including reference to *travaux préparatoires*. The Appellate Body considered “that the classification practice in the European Communities during the Uruguay Round is part of ‘the circumstances of [the] conclusion’ of the WTO Agreement and may be used as a supplementary means of interpretation within the meaning of Article 32 of the Vienna Convention.”⁸³ The Appellate Body finds that the classification practice during the Uruguay Round within the EC was not consistent.

Most puzzling to the Appellate Body is the Panel’s failure to consider the *Harmonized System* and its *Explanatory Notes*⁸⁴ as *travaux préparatoires* or as the context of the conclusion of the GATT 1994 under article 32 of the Vienna Convention.⁸⁵ The Appellate Body also noted the failure of the Panel to consider a 1997 decision of the World Customs Organization (“WCO”) on the proper classification of LAN equipment.⁸⁶ Finally, the Panel did not consider EC customs classification legislation. The Appellate Body pointed out that classification practice among EC member states was not consistent, with LAN equipment treated as telecommunications equipment in at least some member states.

⁷⁸ *India--Patent Protection for Pharmaceutical and Agricultural Products*, adopted 16 January 1998, WT/DS50/AB/R, para. 45.

⁷⁹ In defense of the Panel, it might be argued that the use of the term “legitimate” to qualify “expectations” expresses the need to evaluate the intent of both the importing and exporting state. On the other hand, the Panel made another linguistic error in stating that it could not determine the ordinary meaning of the tariff headings “taken in isolation.” Panel Report, para. 8.31. While article 31 of the Vienna Convention permits interpretation by reference to the object and purpose of the treaty, it does so as a method by which the “ordinary meaning” may be ascertained.

⁸⁰ Appellate Body Report, para. 97.

⁸¹ *India--Patent Protection for Pharmaceutical and Agricultural Products*, adopted 16 January 1998, WT/DS50/AB/R, para. 45.

⁸² Appellate Body Report, para. 84.

⁸³ Appellate Body Report, para. 92.

⁸⁴ See International Convention on the Harmonized Commodity Description and Coding System, done June 14, 1983, 1989 Gr. Brit. T.S. No. 15 (Cmd. 695). See also Edwin A. Vermulst, *EC Customs Classification Rules: Should Ice Cream Melt*, 15 MICH J. INT’L L. 1241 (1994).

⁸⁵ Appellate Body Report, para. 89.

⁸⁶ As stated in the Panel Report, the WCO’s Harmonized System Committee had decided that LAN equipment was properly classified in heading 84.71, in accordance with the U.S. argument. Panel Report, para. 6.34.

What is most puzzling to this reader, however, is the Appellate Body's failure to consider any of these sources itself. This failure does not appear justified by the Appellate Body's limited mandate to consider issues of law raised by the parties.

However, without advancing its own interpretation and thereby giving the U.S. "its day in court," the Appellate Body concludes that the Panel was not justified in reaching its conclusion that the U.S. was "entitled to 'legitimate expectations' that LAN equipment would be accorded tariff treatment as ADP machines in the European Communities and, therefore, that the European Communities acted inconsistently with" GATT.⁸⁷

The Appellate Body's conclusion seems inconsistent with an early, and well-regarded, GATT precedent: *Treatment by Germany of Imports of Sardines*.⁸⁸ In that decision, the panel referred to the history of negotiations as a basis for concluding that Norway had "legitimate expectations" that a certain type of sardine would not be treated less favorably than another type of sardine. The panel assumed that Norway had implicitly taken this treatment into account in assessing the value of German concessions and in offering counter-concessions.⁸⁹ On this basis, the panel found non-violation nullification and impairment.

Burden of Clarification

The EC had argued that the Panel improperly allocated the burden of clarification of its tariff categories to the EC, as the importing state. The Appellate Body, based on its view that tariff concessions are not the sole responsibility of the importing state, but are the joint responsibility of all the states negotiating, concluded that the Panel erred in placing the burden of clarification solely on the EC. Rather, tariff negotiations is a "process of reciprocal demands and concessions" and clarification is "a task for *all* interested parties."⁹⁰

Conclusions

The Appellate Body has appropriately clarified that treaty interpretation in the WTO system must consider the intent of all (or at least both) parties to the treaty. The Panel's shortcut method of interpretation, while perhaps resulting in the same analysis as a bilateral or multilateral determination of intent, was infelicitously described as a search for the "legitimate expectations" of the exporting state. This approach could be salvaged by emphasis on the legitimacy of the expectations, but there was no need to do so.

While the Appellate Body correctly rejected the interpretative methodology used by the Panel, this decision is troubling for the failure of the Appellate Body actually to apply a substitute methodology. In other words, while it was correct to reject a reference to the exporting state's "legitimate expectations," this does not seem a sufficient basis to reject the U.S. claims. Rather, it seems incumbent upon the Appellate Body to perform a full interpretative analysis of its own in order to decide the case. Alternatively, perhaps the Appellate Body should have the capacity to remand to the Panel for a revision in accordance with the Appellate Body's interpretative methodology.⁹¹ Indeed, the Appellate Body never considers the U.S. claim regarding non-violation nullification and impairment, an alternative claim that the Panel did not reach due to its finding of violation. The appellate procedure seems unworkable without some means of ensuring that claims are evaluated in full.

⁸⁷ Appellate Body Report, para. 98 (citations omitted).

⁸⁸ *Treatment by Germany of Imports of Sardines*, adopted 31 October 1952, BISD 1S/53.

⁸⁹ *Id.* para. 16.

⁹⁰ Appellate Body Report, paras. 109-110.

⁹¹ This has been suggested in the current review of the DSU. See *WTO Off to Slow Start on Review of Dispute Settlement Mechanism*, 16:23 Inside U.S. Trade, June 12, 1998, at 9.

Finally, the distinction drawn here, and in the *India--Patents* decision, between violation and non-violation complaints is troubling. Again, reasonable or legitimate expectations are simply an indication of intent. They are not, as the Appellate Body states, subjective, because they are qualified and rendered objective by the requirement of reasonableness or legitimacy of the expectations. In both violation and non-violation complaints, the search is the same: what is the intent of the treaty? The only difference for these purposes is that in non-violation complaints the intent is inferred teleologically without a specific textual prohibition. The alternative would be startling: that the Appellate Body is rejecting teleological interpretation in violation cases.

2. MFN Principle

2-1. INTRODUCTION

Relevant Provisions

Read in the Primary Sources:

- GATT 1994 Article I
- GATS Article II

Overview

Most-Favored Nation (MFN) Principle (Horizontal Non-Discrimination Principle)

Basic Concepts

Simply speaking, MFN principle requires a country to grant any trading partner the same extent of treatment in terms of international commerce as it does to any other trading partners. Although MFN principle can truly be traced back to general principles of law, such as estoppel, it has been often contained and modified mainly for political reasons. Therefore, this principle has been basically dependent for its legal meaning on specific treaties, though sometimes it is argued this principle should be understood as a customary international law.⁹² Very often, the MFN obligation is qualified by certain conditions. Of course, the so-called “conditional” MFN obligation⁹³ would be theoretically problematic, or even oxymoronic, because MFN principle should be in itself “unconditional” and “immediate”.⁹⁴ Yet, since an MFN obligation is created after a country *grants* it to other trading partner through a treaty-making process, conditionality and selective scope often may play certain roles in the negotiating process.

History

Whether to grant an MFN status to trading partners have been oscillating according to political philosophy and calculation.⁹⁵ In the 18th and 19th century Europe, MFN treatment was popular silhouetted against liberalism prevailing all across Europe, and the then superpower England distributed such principle widely. In contrast, the US in the same period showed a rather defensive attitude toward the MFN treatment and thus took a bilateral approach in trade negotiations mainly because as a relatively young country after the independence it tried to ensure some leverage against Europe.⁹⁶

However, after the World War I, the situation changed. The US, thanks to economic development during the war, its main economic status shifted from an importer to an exporter, which prefers the MFN-based multilateralism to bilateral negotiations to expand its market. Moreover, the postwar international liberalism backed up the adoption of MFN principle as symbolized by Wilsonian 14 points one of which is the “establishment of an equality of trade conditions among all the nations” and by the League of Nation Covenant which included the “equitable treatment for the commerce of all members”.⁹⁷

Nonetheless, such atmosphere favorable to the MFN drastically changed due to the reborn protectionism which was attributable to misled policy reaction to the Depression, such as the infamous Smoot-Hawley Tariff Act of 1930 and the preferential trade system of the British

⁹² JOHN H. JACKSON ET AL., *LEGAL PROBLEMS OF ECONOMIC RELATIONS – CASES, MATERIALS AND TEXT ON THE NATIONAL AND INTERNATIONAL REGULATION OF TRANSNATIONAL ECONOMIC RELATIONS* 422-23 (4th ed. 2002).

⁹³ *Id.*, at 418-19.

⁹⁴ GATT Article I.

⁹⁵ See generally JOHN H. JACKSON, *THE WORLD TRADING SYSTEM* 440-42 (2d ed. 1997).

⁹⁶ *Id.*

⁹⁷ JOHN H. JACKSON, *WORLD TRADE AND THE LAW OF GATT* (1969) 250-51.

Commonwealth.⁹⁸ Such protectionism spilled over world-wide rapidly and formed destructively exclusive trading blocs. Such anti-MFN bloc phenomenon continued until GATT 1947 was designed as a post-war architecture of world trading system where MFN principle regained its golden status as a basic obligation of international trade.

MFN Obligations Beyond Article I

Article I is not the only place in which the MFN principle is enshrined. As one can speculate from its title, Article I provides a *general* MFN principle that will be a guiding light throughout the whole GATT. Yet, some other provisions also explicitly or implicitly refers to this fundamental principle.

Article XIII (Non-Discriminatory Administration of Quantitative Restrictions)

Article XIII expressly requires that even in administering quotas a Member state shall treat all third countries on an MFN basis.⁹⁹ This provision has a strong bite since it requires an MFN-based structure to be a prerequisite for initiating any quota. In other words, no Member state can even establish a quota unless its design is based on the MFN principle. One may find a second-best approach embedded in the GATT on the ground of reality check. Though the GATT could not eliminate all the quotas from the start, which would have been an ideal solution, it tried to discipline the administration of such quotas in a way which free trade would be least damaged by them.

Article XIX (Escape Clause: Safeguard)

It has been controversial whether Article XIX can even escape from the obligations of Article I and XIII and thus administer a safeguard measure on a selective basis among Member states.¹⁰⁰ Although one GATT 1947 panel held that even a safeguard quota should be administered in a manner consistent with Article XIII¹⁰¹, the debate never ends.¹⁰²

If one insists on the same rationale found in Article XIII, *i.e.*, a second-best approach, Article XIX should also respect the MFN principle. Yet, political aspects embedded in this provision often make it hard to follow such direction. Ironically, the very possibility of such legal rigor, together with another strict requirement of “serious injury”, has been a main reason why Member states avoid the use of this provision, but instead have recourse to other alternatives in managing imports, such as anti-dumping measures and voluntary export restraints (VERs).

DSU Article 22.1 (Compensation)

DSU Article 22.1 stipulates that “compensation shall be consistent with the covered agreements”. It would be fair to say that such covered agreements naturally include Article I (MFN principle) of GATT 1994. In another sense, one might argue that even “compensation” falls within the rubric of

⁹⁸ *Id.*

⁹⁹ Article I; *See Banana III*

¹⁰⁰ JOHN H. JACKSON ET AL., *LEGAL PROBLEMS OF ECONOMIC RELATIONS – CASES, MATERIALS AND TEXT ON THE NATIONAL AND INTERNATIONAL REGULATION OF TRANSNATIONAL ECONOMIC RELATIONS* 651 (3d ed. 1995).

¹⁰¹ Norway – Restrictions on Imports of Certain Textile Products, adopted on, GATT, 27th Supp. BISD 119, 125-26 (1981).

¹⁰² JACKSON ET AL (3d ed.), *supra* note 9, at 651.

“all rules and formalities in connection with importation and exportation” in Article I, thereby leaving compensation subject to Article I discipline.

In 1998, Japan offered the compensation (tariff concessions) on an MFN basis for the delay of implementing the Panel and the Appellate Body Reports in *Japanese Shochu* (1996).¹⁰³

¹⁰³ Joost Pauwelyn, *Enforcement and Countermeasures in the WTO: Rules are Rules – Toward a More Collective Approach*, 94 AM. J. INT’L L. 335, 337, n. 12 (2000).

Current Developments

INDIA CHALLENGES EU GSP SCHEME ON ENVIRONMENT AND LABOUR STANDARDS

Bridges Weekly News Vol. 7, No. 1 Jan. 15, 2003
<http://www.ictsd.org/weekly/archive.htm>

On 19 December 2002, India requested the establishment of a WTO panel to determine whether provisions under the EU's Generalised System of Preferences (GSP) tariff programme relating to labour rights, the protection of the environment and combating the production and trafficking of illicit drugs is compatible with WTO rules. The dispute request is the first ever to contest a trade measure used to promote respect for labour rights. The EU blocked the first request for the establishment of a panel at a subsequent meeting of the Dispute Settlement Body on the same day. However, any follow-up request from India would automatically be accepted by the DSB, and India has stated that the request will be tabled at a meeting of the Dispute Settlement Body on 27 January. The EU expressed "deep regret and surprise" over India's decision to seek a panel, maintaining that India "has chosen to ignore that the EU's GSP scheme is an autonomous regime granted on a non-reciprocal, generalised and non-discriminatory basis."

The EU GSP programme

The EU's GSP programme grants preferential access to imports from developing countries, favouring countries that apply norms for labour rights and the protection of the environment. India is contesting two provisions under the programme that offer special tariff treatment to countries identified by the EU for their efforts to combat illicit drug production and trafficking as well as countries that comply with labour and environmental policy standards fixed by the EU. In requesting the panel, India says these special tariff preferences are inconsistent with Article I of the WTO's General Agreement on Tariffs and Trade (GATT) requiring any advantage or privilege granted to the imports of one WTO Member to be automatically extended to all Members.

India also claims that the special preferences violates Articles 2(a), 3 (a) and 3(c) of the 28 November 1979 GATT Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, popularly known as the Enabling Clause. Paragraph 2(a) of the Enabling Clause calls for the establishment of "nonreciprocal and nondiscriminatory preferences" under GSP schemes, while paragraphs 3(a) and 3(c) require that preferences be designed to "facilitate and promote the trade of developing countries" and "respond positively to the development, financial and trade needs of developing countries."

The EU's special preferences for combating drug production were targeted by Brazil in a complaint brought in October 2000. Brazil objected to the EU giving special concessions on soluble coffee imported from several of its South American neighbours because of their efforts to combat drugs, while at the same time "graduating" Brazil's coffee exports from the GSP scheme. The two sides later reached a deal giving Brazil duty-free access for up to 10,000 metric tons of soluble coffee.

ICTSD Reporting; "EU Blocks India's Request for Panel on GSP Labor, Environment Provisions," WTO REPORTER, 20 December 2002.

2-2. SPANISH COFFEE

The following two panel reports date from the 1980s and are among the relatively few MFN disputes. Compare the following two GATT panel reports and consider how to legally reconcile them. Focus in particular on the expressly and implicitly applied criteria for the determination of likeness and keep in mind the economic rationale for the MFN obligation.

http://www.wto.org/english/tratop_e/dispu_e/gt47ds_e.htm

27 April 1981

SPAIN - TARIFF TREATMENT OF UNROASTED COFFEE

*Report of the Panel adopted on 11 June 1981
(L/5135 - 28S/102)*

I. Introduction

1.1 In a communication dated 13 September 1979 and circulated to contracting parties, Brazil informed that a new Spanish law had introduced certain modifications in the tariff treatment applied to imports of unroasted coffee, according to which imports into Spain of unroasted non-decaffeinated "unwashed Arabica" and Robusta coffees (tariff No. 09.01A) were now subject to a tariff treatment less favourable than that accorded to "mild" coffee. Prior to this new law there had been no differentiation in the tariff treatment applied by Spain to imports of unroasted coffee. As a main supplier of coffee to Spain, Brazil was concerned with the discriminatory character of the new tariff rates and had requested Article XXII:1 consultations with Spain (L/4832).

(...)

II. Factual aspects

2.1 The following is a brief description of factual aspects of the matter under dispute as the Panel understood them.

2.2 On 8 July 1979, the Spanish authorities enacted the Royal Decree No. 1764/79 (B.O.E. of 20 July) by which the tariff treatment and the sub-tariff classification applied to imports of unroasted, non-decaffeinated coffee (ex. CCCN 09.01) were modified and amended, effective by 1 March 1980. Imports of unroasted coffee, which prior to this last date entered Spain's customs territory under one and the same designation, was sub-divided into five tariff lines to which duty rates applied as follows:

Table 1

Spain's present tariff treatment for unroasted non-decaffeinated coffee beans
(Royal Decree 1764/79 - Tariff No. 09.01. A.1a)

Product description	Duty rate
1. Columbian mild	Free
2. Other mild	Free

3. Unwashed Arabica	7 per cent ad. val.
4. Robusta	7 per cent ad. val.
5. Other	7 per cent ad. val.

2.3 Prior to the Royal Decree 1764/79, imports of unroasted coffee into Spain were subject to a customs duty of 25 per cent ad valorem¹, which was subsequently reduced to 22.5 per cent. In 1975, by Decree-Law 13/75 of 17 November of that year, Spain exempted imports of certain food products, including unroasted coffee, from customs duties when they were imported under the State-trading system.

2.4 Ever since Spain acceded to GATT, customs duties on raw coffee were never bound, and, therefore, not included in Schedule XLV of Spanish concessions in GATT.

2.5 On the same date, 8 July 1979, the Spanish authorities also published the Royal Decree 1765/79 which provided that as from 1 March 1980 imports of unroasted coffee would cease to be under State-trading and would begin to be marketed by private entities. Prior to that, imports of unroasted coffee into Spain were the monopoly of the Office of the General Commissioner for Supply and Transport (CAT) which also had exclusive responsibility for domestic supply.

2.6 Under the State-trading régime and intervention in the domestic market, the use of blends was prohibited in Spain and coffee was obligatorily marketed under the designations Superior, Regular and Popular, which largely corresponded to the types "mild", "unwashed Arabica", and Robusta, respectively. The CAT also maintained a system of maximum authorized prices for each of these types of coffee.

¹Decree 999/60 of 30 May 1960.

2.7 On 30 November 1979, a Ministerial Order (Ministry of Trade and Tourism) did away with the requirement to market coffee under the designations Superior, Regular and Popular. Confirming this removal of obligatory designations, the Resolution of the same Ministry's General Directorate of Domestic Trade, of 8 February 1980, indicated a single maximum price for the domestic sale of these products without distinction as to type.

2.8 This latter resolution having also been superseded, the Panel further understood that, at the present time, domestic coffee prices were free in the Spanish market.

2.9 Spain's imports of raw coffee clearly showed a rising trend over the period 1967-1979 having increased two-fold by volume, and ten-fold by value.

Table 2

Spain's Imports of Raw Coffee
(Tariff No. 09.01.A.1 and Statistical No. 09.01.01)

Year	Metric tons	Million pts.	Main suppliers
1967	42,215	2,378	Colombia, <u>Brazil</u> , Mexico, Angola
1968	49,075	2,997	Colombia, <u>Brazil</u> , Angola, Mexico
1969	61,877	3,767	Colombia, <u>Brazil</u> , Angola, Mexico
1970	78,963	5,747	Colombia, <u>Brazil</u> , Angola, Uganda
1971	66,353	4,916	Colombia, <u>Brazil</u> , Angola, Mexico
1972	80,239	5,786	Colombia, <u>Brazil</u> , Angola, Equatorial Guinea
1973	73,464	5,789	<u>Brazil</u> , Colombia, Angola, Mexico

1974	84,898	7,215	Colombia, <u>Brazil</u> , Angola, Mexico
1975	75,788	6,325	Colombia, Angola, Ivory Coast, <u>Brazil</u>
1976	91,698	13,765	<u>Brazil</u> , Ivory Coast, Uganda, Colombia
1977	77,479	31,693	<u>Brazil</u> , Ivory Coast, Colombia, Uganda
1978	83,226	24,452	Colombia, <u>Brazil</u> , El Salvador, Ivory Coast
1979	99,621	22,291	Colombia, Uganda, <u>Brazil</u> , Ivory Coast

Source: Foreign Trade Statistics of Spain - General Directorate of Customs.

Note: The above figures cover only imports into the Peninsula and the Balearic Islands and exclude imports into Free Zones.

2.10 The increases in value and volume were not parallel, owing not only to international market fluctuations but also to differences in the composition of the Spanish imports, in terms of types of coffee. While varying, the main suppliers always included both Brazil and Colombia, although neither was always the principal supplier.

2.11 Spain's imports of unroasted coffee from Brazil were constituted of almost entirely "unwashed Arabica", and they evolved in most recent times as shown by Table 3.

Table 3

Spain's Imports of Raw Coffee (metric tons)

	1976	1977	1978	1979	March-September 1980
Total	91,698	77,749	83,226	99,621	74,668
of which from Brazil:	40,672	24,946	18,137	18,573	21,004
% of total	44.35	32.08	21.69	18.64	28.13

Source: see Table 2.

III. Main arguments

Article I:1

3.1 The representative of Brazil argued that by introducing a 7 per cent tariff rate on imports of unroasted, non-decaffeinated coffee of the "unwashed Arabica" and Robusta groups, while affording duty-free treatment to coffee of other groups, the new Spanish tariff régime was discriminatory against Brazil, which exports mainly "unwashed Arabica", but also Robusta coffee, and therefore was in violation of Article I:1 of the General Agreement, according to which:

"... any advantage, favour, privilege or immunity granted by any contracting party to any product originating in ... any other country shall be accorded immediately and unconditionally to the like product originating in ... the territories of all other contracting parties."

3.2 In this connection, he noted that, as did Spain herself under her previous tariff régime, no other contracting party discriminated in its customs tariff as between "types" or as among "groups" of coffee.

3.3 The representative of Spain, stressed that no contracting party was obliged to retain either its tariff structure, or its duties, applicable to the importation of products which have not been bound. He recalled that the Brussels nomenclature adopted by Spain did specify tariff headings but left it to each country to establish, if it is so wished, sub-headings within these headings. Accordingly, the Spanish authorities had the right to establish within a given heading the sub-divisions which were most suited to the characteristics of Spain's foreign trade, while respecting, as Spain has done on many occasions, the bound duties previously negotiated.¹ The classification criterion adopted was based on classifications made by international organizations, specifically the International Coffee Organization (ICO).

3.4 In order to ascertain the coverage of Article I:1 it was necessary, in the view of the Spanish representative, to consider two aspects in detail: (a) meaning of the term "like products", and (b) existence of any preference or pretermission in respect of a country as a consequence of the new structure of heading No. 09.01.A.1 of the Spanish tariff. The Spanish authorities continued to hold that, in their judgment, the provisions of the Royal Decree 1764/79 were fully compatible with the obligations assumed by Spain under the General Agreement, and in particular Article I:1 thereof.

¹In this respect, the representative of Brazil requested the Panel to take note of the oral recognition made by the Spanish representative in the course of the first hearing of the Panel that Article I of GATT applied equally to bound and unbound tariff items.

These authorities furnished photocopies of importing licences in Spain, issued after 1 March 1980, which evidenced that the new tariff classification was applied according to the nature of products, and completely independently of the country of origin. In particular, these licences evidenced that Brazilian "washed" coffee was imported into Spain free of duty.

"Like products"

3.5 Recalling that in some past GATT cases it had been suggested that "like products" were all the products falling within the same tariff heading, the representative of Spain did not agree with that opinion. In his view, this interpretation could lead to serious mistakes, given that products falling within one and the same tariff heading could be unlike and clearly different, as for example: (i) in the case of all the residual tariff headings ("other products not specified"), covering a large number of heterogeneous products, and (ii) headings including homogeneous products where in many instances these were not "like products" (i.e. CCCN heading No. 15.07 including all kinds of vegetable oils; CCCN heading No. 22.05 including all wines, etc.).

3.6 The Spanish representative pointed out that qualitative differences did exist between various types of coffee considering both technico-agronomic, economic and commercial criteria. He argued that Robusta coffee bean was morphologically different from the Arabica coffee bean, having a different chemical composition and yielding a neutral beverage that was lacking in aroma and was richer in soluble solids than the beverage made from Arabica coffee.

3.7 Although both "mild" and "unwashed Arabica" coffees belonged to the group of Arabica, the Spanish representative further argued that differences in quality also existed between them, as a result of climatic and growing conditions as well as methods of cultivation and above all the preparation because aroma and taste, essential features in determining trade and consumption of these products, were completely different in "washed" and "unwashed" Arabica coffees. Different quotations in international trade and commodity markets were due to these factors.

3.8 As distinctive markets existed for the various types of unroasted coffee, the Spanish representative was of the view that such various types of coffee could not be regarded as "like products". This was

particularly evident in the Spanish market where, for historical reasons, consumers' preference for the various types of coffee was well established, in contrast with other markets in which the use of blends was more generalized. When referring to the increasing market share of blends outside Spain, he argued that the existence of blends proved that the various types of coffee were not the same products.

3.9 For his part, the representative of Brazil argued that coffee was one single product and that, therefore, for the purpose of Article I:1 of the GATT, must be considered a "like product". He further argued that in the specific case of "mild" and "unwashed Arabica" coffees, both came from the same species of plant, and often from the same variety of tree. He also stated that, in such cases, the product could be extracted from the same individual tree, and the classification as "unwashed Arabica" or "mild" would depend exclusively on the treatment given to the berries.

3.10 He pointed out, therefore, that existing differences between "growths" or "groups" of coffee were essentially of an organoleptic nature (taste, aroma, body, etc.) resulting from geographical conditions and, principally, from the distinct methods of preparation of the beans.

3.11 He stated that the classification presently used by Spain for tariff purposes had been introduced by the International Coffee Organization in 1965/66, when the Council of the Organization decided to create groupings of coffee-producing countries as part of a system for the limited adjustment of export quotas in response to changes in an indicator price of "mild Arabicas", "unwashed Arabicas" and "Robustas". He further stated that the composition of each grouping depended upon political decisions taken yearly by the Council of the Organization, according to which each exporting country was placed in the group corresponding to the kind of coffee constituting the greater part of its production. He stressed that since 1972 these groupings had only served a statistical purpose.

3.12 He argued that, from the point of view of the consumer, virtually all coffee, either roasted or soluble, was sold today in the form of blends, combining in varying proportions coffee belonging to different groups. Moreover, in everyday language, the terms type, quality, and growth were used interchangeably to indicate specific grades of coffee, for instance Colombian Mams, El Salvador Central Standard, Paraná 4, Angola Ambriz 2AA, etc. In his view, this was the only characterization really meaningful for trading purposes, since no roaster did buy a "Colombian mild" or "unwashed Arabica" as such, but rather well-known grades, priced according to the beverage they could provide.

3.13 He further stated that with respect to its end use, coffee was a well determined and one single product, generally intended for drinking as a beverage.

Differentiation made in the Spanish tariff

3.14 Explaining the economic reasons beyond the differentiation introduced in the Spanish tariff by the Royal Decree No. 1764/79, the representative of Spain said that the lower customs duty applicable to "mild" coffee imported into Spain reflected the Spanish Government's deep concern over the possible impact on prices of measures to return coffee to the private sector and afford greater trade liberalization. In this connection, he noted that coffee accounted for more than 2 per cent in the Spanish consumer price index. He also said that in the previous trade system of State-trading in which a nil tariff duty existed since 1975, nevertheless the difference between import prices and selling prices to roasters ("precios de cesión") in practice constituted an implicit tariff affecting all imports of coffee. This implicit tariff was higher than the tariff duties effectively applied since March 1980.

3.15 Having recalled that a very high proportion of "mild" coffee was consumed in the Spanish market, he noted that this very high proportion of "mild" in Spanish consumption had been maintained by keeping artificially low the retail price of "mild" coffee through the operation of the previously existing system of authorized prices.

3.16 In view of the foregoing, he indicated that his authorities had considered that the only way of reconciling consumers' preference for "mild" coffee and the transfer of the coffee trade to the private sector was to establish different rates of custom duty, with a zero duty on the most expensive coffee, i.e. "mild" coffee. In so doing, his authorities had not at any time given any thought to which countries were producing the different types of coffee. In fact, different types or groups of coffee were often grown in one and the same country and more than thirty countries were producing both Robusta and "unwashed Arabica".

3.17 Finally, the Spanish representative stressed the transitional character of the coffee import régime actually applied by his country. He said that his authorities ultimately aimed, in the shortest possible time, at introducing in respect of coffee a system of automatic licensing and free domestic trade.

3.18 Referring to the stated anti-inflation objective of the Spanish measures, the representative of Brazil was of the view that such argument was not relevant to the case under dispute, since, whatever the motivation to introduce the new tariff régime for unroasted coffee, such motivation did not exempt Spain from complying with the provisions of Article I:1 of the GATT.

(...)

IV. Findings and conclusions

(...)

4.2 The Panel considered that it was called upon to examine whether the Spanish tariff régime for unroasted coffee introduced by Spain through the Royal Decree 1764/79 (ref. paragraph 2.2) was consistent with Spanish obligations under the GATT, and more precisely whether it was in conformity with the most-favoured-nation provision of Article I:1.

4.3 Having noted that Spain had not bound under the GATT its tariff rate on unroasted coffee, the Panel pointed out that Article I:1 equally applied to bound and unbound tariff items.

4.4 The Panel found that there was no obligation under the GATT to follow any particular system for classifying goods, and that a contracting party had the right to introduce in its customs tariff new positions or sub-positions as appropriate.¹ The Panel considered, however, that, whatever the classification adopted, Article I:1 required that the same tariff treatment be applied to "like products".

4.5 The Panel, therefore, in accordance with its terms of reference, focused its examination on whether the various types of unroasted coffee listed in the Royal Decree 1764/79 should be regarded as "like products" within the meaning of Article I:1. Having reviewed how the concept of "like products" had been applied by the CONTRACTING PARTIES in previous cases involving, inter alia, a recourse to Article I:1² the Panel noted that neither the General Agreement nor the settlement of previous cases gave any definition of such concept.

4.6 The Panel examined all arguments that had been advanced during the proceedings for the justification of a different tariff treatment for various groups and types of unroasted coffee. It noted that these arguments mainly related to organoleptic differences resulting from geographical factors, cultivation methods, the processing of the beans, and the genetic factor. The Panel did not consider that such differences were sufficient reason to allow for a different tariff treatment. It pointed out that it was not unusual in the case of agricultural products that the taste and aroma of the end-product would differ because of one or several of the above-mentioned factors.

4.7 The Panel furthermore found relevant to its examination of the matter that unroasted coffee was mainly, if not exclusively, sold in the form of blends, combining various types of coffee, and that coffee in its end-use, was universally regarded as a well-defined and single product intended for drinking.

4.8 The Panel noted that no other contracting party applied its tariff régime in respect of unroasted, non-decaffeinated coffee in such a way that different types of coffee were subject to different tariff rates.

4.9 In the light of the foregoing, the Panel concluded that unroasted, non-decaffeinated coffee beans listed in the Spanish Customs Tariffs under CCCN 09.01 A.1a, as amended by the Royal Decree 1764/79, should be considered as "like products" within the meaning of Article I:1.

4.10 The Panel further noted that Brazil exported to Spain mainly "unwashed Arabica" and also Robusta coffee which were both presently charged with higher duties than that applied to "mild" coffee. Since these were considered to be "like products", the Panel concluded that the tariff régime as presently applied by Spain was discriminatory vis-à-vis unroasted coffee originating in Brazil.

4.11 Having recalled that it had found the tariff régime for unroasted coffee introduced by Spain through the Royal Decree 1764/79 not to be in conformity with the provision of Article I:1, the Panel further concluded that this constituted prima facie a case of impairment of benefits accruing to Brazil within the meaning of Article XXIII.

4.12 In the light of the above, the Panel suggest that the CONTRACTING PARTIES request Spain to take the necessary measures in order to make its tariff régime for unroasted coffee conform to Article I:1.

¹Provided that a reclassification subsequent to the making of a concession under the GATT would not be a violation of the basic commitment regarding that concession (Article II:5).

²BISD Vol. II/188; BISD S1/53; BISD S25/49; L/5047.

2-3. JAPAN – LUMBER

http://www.wto.org/english/tratop_e/dispu_e/gt47ds_e.htm

JAPAN – TARIFF ON IMPORTS OF SPRUCE, PINE, FIR (SPF) DIMENSION LUMBER

Report of the Panel adopted on 19 July 1989

5.4 According to Canada, Article I:1 required Japan to accord also to SPF dimension lumber the advantage of the zero tariff granted by Japan, under sub-position 4407.10-320 of its Tariff, to planed and sanded lumber of "other" coniferous trees (...).

5.5 The Panel noted that the tariff classification for 4407.10-110 had been established autonomously by Japan, without negotiation.

(...)

5.7 In view of analysing the factual situation submitted to it under its terms of reference, the Panel had first to consider the legal framework in which the Canadian complaint had been raised. In substance, Canada complains of the fact that Japan had arranged its tariff classification in such a way that a considerable part of Canadian exports of SPF dimension lumber to Japan was submitted to a customs duty of 8 per cent, whereas other comparable types of dimension lumber enjoy the advantage of a zero-tariff duty. The Panel considered it impossible to appreciate fully the Canadian complaint if it had not in a preliminary way clarified the bearing of some principles of the GATT-system in relation to tariff structure and tariff classification.

5.8 The Panel noted in this respect that the General Agreement left wide discretion to the contracting parties in relation to the structure of national tariffs and the classification of goods in the framework of such structure (see the report of the Panel on Tariff Treatment of Unroasted Coffee, BISD 28S/102, at III, paragraph 4.4). The adoption of the Harmonized System, to which both Canada and Japan have adhered, had brought about a large measure of harmonization in the field of customs classification of goods, but this system did not entail any obligation as to the ultimate detail in the respective tariff classifications. Indeed, this nomenclature has been on purpose structured in such a way that it leaves room for further specifications.

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. It must however be borne in mind that such differentiations may lend themselves to abuse, insofar as they may serve to circumscribe tariff advantages in such a way that they are conducive to discrimination among like products originating in different contracting parties. A contracting party prejudiced by such action may request therefore that its own exports be treated as "like products" in spite of the fact that they might find themselves excluded by the differentiations retained in the importing country's tariff.

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. Such complaints have to be examined in considering simultaneously the internal protection interest involved in a given tariff specification, as well as its actual or potential influence on the pattern of imports from different extraneous sources. The Canadian complaint and the defence of Japan will have to be viewed in the light of these requirements.

5.11 "Dimension lumber" as understood by Canada is defined by its presentation in a standard form of measurements, quality-grading and finishing. It appears from the information provided by Canada

that this type of lumber is largely used in platform-house construction in Canada as well as in the United States and that it has found also widespread use in Japan, as is testified by the existence of a Japanese technical standard known under the name of "JAS 600".

5.12 Japan objected to this claim on different grounds. Japan explained that dimension lumber was only one particular type of lumber among many other possible presentations and that house-building is only one of the many possible uses of this particular kind of lumber. From the legal point of view, Japan contended that the concept of "dimension lumber" is not used either in any internationally accepted tariff classification, or in the Japanese tariff classification. In accordance with the Harmonized System, position No. 4407.10 embraces all types of coniferous wood "sawn or chipped lengthwise ... exceeding 6mm". Apart from the thickness and the grade of finishing, customs treatment of lumber according to the Japanese Tariff was determined exclusively on the basis of a distinction established between certain biological genera or species. Dimension lumber was therefore not identified as a particular category in the framework of the Japanese tariff classification.

5.13 The Panel considered that the tariffs referred to by the General Agreement are, quite evidently, those of the individual contracting parties. This was inherent in the system of the Agreement and appeared also in the current practice of tariff negotiations, the subject matter of which were the national tariffs of the individual contracting parties. It followed that, if a claim of likeness was raised by a contracting party in relation to the tariff treatment of its goods on importation by some other contracting party, such a claim should be based on the classification of the latter, i.e. the importing country's tariff.

5.14 The Panel noted in this respect that "dimension lumber" as defined by Canada was a concept extraneous to the Japanese Tariff. It was a standard applied by the Canadian industry which appeared to have some equivalent in the United States and in Japan itself, but it could not be considered for that reason alone as a category for tariff classification purposes, nor did it belong to any internationally accepted customs classification. The Panel concluded therefore that reliance by Canada on the concept of dimension lumber was not an appropriate basis for establishing "likeness" of products under Article I:1 of the General Agreement.

5.15 At the same time, the Panel felt unable to examine the Canadian complaint in a broader context, as Canada had declared expressly that the issue before the Panel should not be confused by broadening the scope of the Panel's examination beyond 'dimension lumber' to planed lumber generally. Canada's complaint was limited to the specific product known in North America, and also in Japan, as dimension lumber. Canada did not contend that different lumber species per se should be considered like products, regardless of the product-form they might take (see para. 3.15 above). Thus there appeared to be no basis for examining the issue raised by Canada in the general context of the Japanese tariff classification.

2-4. EXCEPTIONS

Regionalism (cf. Class 2)

GATT Art. XXIV and GATS Art. V

Enabling Clause and GSP

(http://www.wto.org/english/tratop_e/devel_e/d2legl_e.htm)

Enabling Clause for developing countries (goods)

The Enabling Clause, officially called the “Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries” was adopted under GATT in 1979 and enables developed members to give differential and more favorable treatment to developing countries.

The Enabling Clause is the WTO legal basis for the **Generalized System of Preferences (GSP)** and the **Global System of Trade Preferences (GSTP)**.

Under the Generalized System of Preferences, developed countries offer non-reciprocal preferential treatment (such as zero or low duties on imports) to products originating in developing countries. Preference-giving countries unilaterally determine which countries and which products are included in their schemes.

Under the Global System of Trade Preferences, developing countries which are members of the **Group of 77** (links to Group 77 website) exchange trade concessions among themselves. UNCTAD provides technical assistance to beneficiaries and conducts analyses of the various schemes.

The Enabling Clause is also the legal basis for **regional arrangements** among developing countries.

Waiver (Lomé Convention)

(http://www.wto.org/english/tratop_e/devel_e/d2legl_e.htm#wavers)

Waivers

Going beyond legal provisions stated explicitly in WTO agreements, actions in favor of developing countries may also be taken under “**waivers**” from the main WTO rules.

These waivers are granted by the General Council according to procedures set out in Article IX:3 of the Marrakesh Agreement Establishing the WTO. Recent examples of waivers include the EC/France Trading Arrangements with Morocco, the US — Caribbean Basin Economic Recovery Act (CBERA), the Canadian Tariff Treatment for Commonwealth Caribbean Countries (CARIBCAN), the US — Andean Trade Preference Act, and the ACP-EC Partnership Agreement (currently under consideration).

2-5. EU – GSP (2004)

http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm

WORLD TRADE ORGANIZATION

WT/DS246/AB/R

7 April 2004

(04-1556)

Original: English

European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries

AB-2004-1

Report of the Appellate Body

(...)

I. Introduction

1. The European Communities appeals certain issues of law and legal interpretations developed in the Panel Report, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries* (the "Panel Report").¹⁰⁴ The Panel was established to consider a complaint by India against the European Communities regarding the conditions under which the European Communities accords tariff preferences to developing countries pursuant to Council Regulation (EC) No. 2501/2001 of 10 December 2001 "applying a scheme of generalised tariff preferences for the period from 1 January 2002 to 31 December 2004" (the "Regulation").¹⁰⁵

2. The Regulation provides for five preferential tariff "arrangements"¹⁰⁶, namely:

- (a) general arrangements described in Article 7 of the Regulation (the "General Arrangements");
- (b) special incentive arrangements for the protection of labour rights;
- (c) special incentive arrangements for the protection of the environment;
- (d) special arrangements for least-developed countries; and
- (e) special arrangements to combat drug production and trafficking (the "Drug Arrangements").¹⁰⁷

(...)

6. India requested the Panel to find that "the Drug Arrangements set out in Article 10"¹⁰⁸ of the Regulation are inconsistent with Article I:1 of the *General Agreement on Tariffs and Trade*

¹⁰⁴WT/DS246/R, 1 December 2003.

¹⁰⁵*Official Journal of the European Communities*, L Series, No. 346 (31 December 2001), p. 1 (Exhibit India-6 submitted by India to the Panel).

¹⁰⁶Regulation, Art. 1.2.

¹⁰⁷*Ibid.*

¹⁰⁸*Ibid.*, para. 3.1 (referring to India's first written submission to the Panel, para. 67).

1994 (the "GATT 1994") and are not justified by the Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries (the "Enabling Clause").¹⁰⁹ In the Panel Report, circulated to Members of the World Trade Organization (the "WTO") on 1 December 2003, the Panel concluded that:

- (a) India has the burden of demonstrating that the European Communities' Drug Arrangements are inconsistent with Article I:1 of GATT 1994;
- (b) India has demonstrated that the European Communities' Drug Arrangements are inconsistent with Article I:1 of GATT 1994;
- (c) the European Communities has the burden of demonstrating that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause; [and]
- (d) the European Communities has failed to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause[.]¹¹⁰

The Panel also concluded that the European Communities had "failed to demonstrate that the Drug Arrangements are justified under Article XX(b) of GATT 1994".¹¹¹ Finally, the Panel concluded, pursuant to Article 3.8 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), that "because the Drug Arrangements are inconsistent with Article I:1 of GATT 1994 and not justified by Article 2(a) of the Enabling Clause or Article XX(b) of GATT 1994, the European Communities has nullified or impaired benefits accruing to India under GATT 1994."¹¹²

(...)

IV. The Relationship Between Article I:1 of the GATT 1994 and the Enabling Clause

(...)

C. Characterization of the Enabling Clause

1. Text of Article I:1 and the Enabling Clause

89. In considering whether the Enabling Clause is an exception to Article I:1 of the GATT 1994, we look, first, to the text of the provisions at issue. Article I:1, which embodies the MFN principle, provides:

¹⁰⁹GATT Document L/4903, 28 November 1979, BISD 26S/203 (attached as Annex 2 to this Report).

¹¹⁰Panel Report, para. 8.1(a)-(d).

¹¹¹*Ibid.*, para. 8.1(e).

¹¹²*Ibid.*, para. 8.1(f).

Article I

General Most-Favoured-Nation Treatment

1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III,* any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

Article I:1 plainly imposes upon WTO Members the obligation to treat "like products ... equally, irrespective of their origin".¹¹³

90. We turn now to the Enabling Clause, which has become an integral part of the GATT 1994.¹¹⁴ Paragraph 1 of the Enabling Clause, which applies to all measures authorized by that Clause, provides:

Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties. (footnote omitted)

The ordinary meaning of the term "notwithstanding" is, as the Panel noted¹¹⁵, "[i]n spite of, without regard to or prevention by".¹¹⁶ By using the word "notwithstanding", paragraph 1 of the Enabling Clause permits Members to provide "differential and more favourable treatment" to developing countries "in spite of" the MFN obligation of Article I:1. Such treatment would otherwise be inconsistent with Article I:1 because that treatment is not extended to all Members of the WTO

¹¹³ Appellate Body Report, *EC – Bananas III*, para. 190.

¹¹⁴ In response to questioning at the oral hearing, the participants and third participants agreed that the Enabling Clause is one of the "other decisions of the CONTRACTING PARTIES" within the meaning of paragraph 1(b)(iv) of the language of Annex 1A incorporating the GATT 1994 into the *WTO Agreement*. That provision stipulates that:

1. The General Agreement on Tariffs and Trade 1994 ("GATT 1994") shall consist of:
 - ...
 - (b) the provisions of the legal instruments set forth below that have entered into force under the GATT 1947 before the date of entry into force of the WTO Agreement:
 - ...
 - (iv) other decisions of the CONTRACTING PARTIES to GATT 1947[.]

¹¹⁵ See Panel Report, para. 7.44.

¹¹⁶ *Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 2, p. 1948.

"immediately and unconditionally".¹¹⁷ Paragraph 1 thus excepts Members from complying with the obligation contained in Article I:1 for the purpose of providing differential and more favourable treatment to developing countries, provided that such treatment is in accordance with the conditions set out in the Enabling Clause. As such, the Enabling Clause operates as an "exception" to Article I:1.

2.Object and Purpose of the *WTO Agreement* and the Enabling Clause
(...)

100.We examine now the European Communities' appeal regarding the Panel's finding that the Enabling Clause "does not exclude the applicability" of Article I:1 of the GATT 1994.¹¹⁸ (...)

101.It is well settled that the MFN principle embodied in Article I:1 is a "cornerstone of the GATT" and "one of the pillars of the WTO trading system"¹¹⁹, which has consistently served as a key basis and impetus for concessions in trade negotiations. However, we recognize that Members are entitled to adopt measures providing "differential and more favourable treatment" under the Enabling Clause. Therefore, challenges to such measures, brought under Article I:1, cannot succeed where such measures are in accordance with the terms of the Enabling Clause. In our view, this is so because the text of paragraph 1 of the Enabling Clause ensures that, to the extent that there is a conflict between measures under the Enabling Clause and the MFN obligation in Article I:1, the Enabling Clause, as the more specific rule, prevails over Article I:1. In order to determine whether such a conflict exists, however, a dispute settlement panel should, as a first step, examine the consistency of a challenged measure with Article I:1, as the general rule. If the measure is considered at this stage to be inconsistent with Article I:1, the panel should then examine, as a second step, whether the measure is nevertheless justified by the Enabling Clause. It is only at this latter stage that a final determination of consistency with the Enabling Clause or inconsistency with Article I:1 can be made.

(...)

103.It is with this understanding, therefore, that we *uphold* the Panel's finding, in paragraph 7.53 of the Panel Report, that the Enabling Clause "does not exclude the applicability" of Article I:1 of the GATT 1994.

(...)

V.Whether the Drug Arrangements are Justified Under the Enabling Clause

(...)

B.Interpretation of the Term "Non-Discriminatory" in Footnote 3 to Paragraph 2(a) of the Enabling Clause

¹¹⁷GATT 1994, Art. I:1.

¹¹⁸Panel Report, para. 7.53.

¹¹⁹Appellate Body Report, *Canada – Autos*, para. 69. See also, Appellate Body Report, *US – Section 211 Appropriations Act*, para. 297, which reads:

Like the national treatment obligation, the obligation to provide most-favoured-nation treatment has long been one of the cornerstones of the world trading system. For more than fifty years, the obligation to provide most-favoured-nation treatment in Article I of the GATT 1994 has been both central and essential to assuring the success of a global rules-based system for trade in goods.

153. (...) Thus, based on the ordinary meanings of "discriminate", India and the European Communities effectively appear to agree that, pursuant to the term "non-discriminatory" in footnote 3, similarly-situated GSP beneficiaries should not be treated differently.¹²⁰ The participants disagree only as to the basis for determining whether beneficiaries are similarly-situated.

(...)

155.(...) We note first that footnote 3 to paragraph 2(a) stipulates that, in addition to being "non-discriminatory", tariff preferences provided under GSP schemes must be "generalized". According to the ordinary meaning of that term, tariff preferences provided under GSP schemes must be "generalized" in the sense that they "apply more generally; [or] become extended in application".¹²¹ However, this ordinary meaning alone may not reflect the entire significance of the word "generalized" in the context of footnote 3 of the Enabling Clause, particularly because that word resulted from lengthy negotiations leading to the GSP. In this regard, we note the Panel's finding that, by requiring tariff preferences under the GSP to be "generalized", developed and developing countries together sought to eliminate existing "special" preferences that were granted only to certain designated developing countries.¹²² Similarly, in response to our questioning at the oral hearing, the participants agreed that one of the objectives of the 1971 Waiver Decision and the Enabling Clause was to eliminate the fragmented system of special preferences¹²³ that were, in general, based on historical and political ties between developed countries and their former colonies.

156.It does not necessarily follow, however, that "non-discriminatory" should be interpreted to require that preference-granting countries provide "identical" tariff preferences under GSP schemes to "all" developing countries. In concluding otherwise, the Panel assumed that allowing tariff preferences such as the Drug Arrangements would necessarily "result [in] the collapse of the whole GSP system and a return back to special preferences favouring selected developing

¹²⁰We note that the contrasting definitions proffered by the participants, as well as the convergence of those definitions on the fact that similarly-situated entities should not be treated differently, find reflection in the use of the term "discrimination" in general international law. In this respect, we note, as an example, the definitions of "discrimination" provided by the European Communities, in footnotes 56 and 57 of its appellant's submission:

⁵⁶ ... Mere differences of treatment do not necessarily constitute discrimination ... discrimination may in general be said to arise where those who are in all material respects the same are treated differently, or where those who are in material respects different are treated in the same way.

(quoting R. Jennings and A. Watts (eds.), *Oppenheim's International Law*, 9th ed. (Longman, 1992), Vol. I, p. 378)

⁵⁷ ... Discrimination occurs when in a legal system an inequality is introduced in the enjoyment of a certain right, or in a duty, while there is no sufficient connection between the inequality upon which the legal inequality is based, and the right or the duty in which this inequality is made.

(quoting E.W. Vierdag, *The Concept of Discrimination in International Law*, (Martinus Nijhoff, 1973), p. 61)

¹²¹*Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002), Vol. 1, p. 1082.

¹²²Panel Report, paras. 7.135-7.137. The Panel also observed that statements by developed and developing countries indicated the aim of providing GSP schemes with a broad scope, encompassing the granting of preferences by *all* developed countries to *all* developing countries. (*Ibid.*, paras. 7.131-7.132)

¹²³See also European Communities' appellant's submission, para. 175.

countries".¹²⁴ To us, this conclusion is unwarranted. We observe that the term "generalized" requires that the GSP schemes of preference-granting countries remain generally applicable.¹²⁵ Moreover, unlike the Panel, we believe that the Enabling Clause sets out sufficient conditions on the granting of preferences to protect against such an outcome. As we discuss below¹²⁶, provisions such as paragraphs 3(a) and 3(c) of the Enabling Clause impose specific conditions on the granting of different tariff preferences among GSP beneficiaries.

(...)

165. Accordingly, we are of the view that, by requiring developed countries to "respond positively" to the "needs of developing countries", which are varied and not homogeneous, paragraph 3(c) indicates that a GSP scheme may be "non-discriminatory" even if "identical" tariff treatment is not accorded to "all" GSP beneficiaries. Moreover, paragraph 3(c) suggests that tariff preferences under GSP schemes may be "non-discriminatory" when the relevant tariff preferences are addressed to a particular "development, financial [or] trade need" and are made available to all beneficiaries that share that need.

(...)

173. Having examined the text and context of footnote 3 to paragraph 2(a) of the Enabling Clause, and the object and purpose of the *WTO Agreement* and the Enabling Clause, we conclude that the term "non-discriminatory" in footnote 3 does not prohibit developed-country Members from granting different tariffs to products originating in different GSP beneficiaries, provided that such differential tariff treatment meets the remaining conditions in the Enabling Clause. In granting such differential tariff treatment, however, preference-granting countries are required, by virtue of the term "non-discriminatory", to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the "development, financial and trade needs" to which the treatment in question is intended to respond.

174. For all of these reasons, we *reverse* the Panel's finding, in paragraphs 7.161 and 7.176 of the Panel Report, that "the term 'non-discriminatory' in footnote 3 [to paragraph 2(a) of the Enabling Clause] requires that identical tariff preferences under GSP schemes be provided to all developing countries without differentiation, except for the implementation of a priori limitations."¹²⁷

(...)

D. Consistency of the Drug Arrangements with the Enabling Clause

¹²⁴Panel Report, para. 7.102.

¹²⁵The European Communities argues in this respect that the GATT Contracting Parties and the WTO Members have granted a number of waivers, as mentioned in the Panel Report, for tariff preferences that are "confined *ab initio* and permanently to a limited number of developing countries located in a certain geographical region". (European Communities' appellant's submission, paras. 184-185 (referring to Panel Report, para. 7.160)) See also, Panel Report, footnote 31 to para. 4.32 (referring to Waiver Decision on the Caribbean Basin Economic Recovery Act, GATT Document L/5779, 15 February 1985, BISD 31S/20, renewed 15 November 1995, WT/L/104; Waiver Decision on CARIBCAN, GATT Document L/6102, 28 November 1986, BISD 33S/97, renewed 14 October 1996, WT/L/185; Waiver Decision on the United States – Andean Trade Preference Act, GATT Document L/6991, 19 March 1992, BISD 39S/385, renewed 14 October 1996, WT/L/184; Waiver Decision on The Fourth ACP-EEC Convention of Lomé, GATT Document L/7604, 9 December 1994, BISD 41S/26, renewed 14 October 1996, WT/L/186; and Waiver Decision on European Communities – The ACP-EC Partnership Agreement, WT/MIN (01)/15, 14 November 2001.

¹²⁶*Infra*, paras. **Error! Reference source not found.-Error! Bookmark not defined.**

¹²⁷Given our interpretation, which permits differentiation among GSP beneficiaries, it is not necessary for us to rule on whether *a priori* limitations are permitted under the Enabling Clause. (See also, *supra*, paras. **Error! Reference source not found.-Error! Reference source not found.**)

(...)

187. We recall our conclusion that the term "non-discriminatory" in footnote 3 of the Enabling Clause requires that identical tariff treatment be available to all similarly-situated GSP beneficiaries. We find that the measure at issue fails to meet this requirement for the following reasons. First, as the European Communities itself acknowledges, according benefits under the Drug Arrangements to countries other than the 12 identified beneficiaries would require an amendment to the Regulation. Such a "closed list" of beneficiaries cannot ensure that the preferences under the Drug Arrangements are available to all GSP beneficiaries suffering from illicit drug production and trafficking.

188. Secondly, the Regulation contains no criteria or standards to provide a basis for distinguishing beneficiaries under the Drug Arrangements from other GSP beneficiaries. Nor did the European Communities point to any such criteria or standards anywhere else, despite the Panel's request to do so.¹²⁸ As such, the European Communities cannot justify the Regulation under paragraph 2(a), because it does not provide a basis for establishing whether or not a developing country qualifies for preferences under the Drug Arrangements. Thus, although the European Communities claims that the Drug Arrangements are available to all developing countries that are "similarly affected by the drug problem"¹²⁹, because the Regulation does not define the criteria or standards that a developing country must meet to qualify for preferences under the Drug Arrangements, there is no basis to determine whether those criteria or standards are discriminatory or not.

189. For all these reasons, we find that the European Communities has failed to prove that the Drug Arrangements meet the requirement in footnote 3 that they be "non-discriminatory". Accordingly, we *uphold*, for different reasons, the Panel's conclusion, in paragraph 8.1(d) of the Panel Report, that the European Communities "failed to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause".

(...)

ANNEX 2

DIFFERENTIAL AND MORE FAVOURABLE TREATMENT RECIPROCITY AND FULLER PARTICIPATION OF DEVELOPING COUNTRIES

*Decision of 28 November 1979
(L/4903)*

Following negotiations within the framework of the Multilateral Trade Negotiations, the CONTRACTING PARTIES *decide* as follows:

1. Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries¹, without according such treatment to other contracting parties.
2. The provisions of paragraph 1 apply to the following:²

¹²⁸See *supra*, footnote **Error! Bookmark not defined.**

¹²⁹European Communities' appellant's submission, para. 186.

- (a) Preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalized System of Preferences,³
- (b) Differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures governed by the provisions of instruments multilaterally negotiated under the auspices of the GATT;
- (c) Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another
- (d) Special treatment of the least developed among the developing countries in the context of any general or specific measures in favour of developing countries.

3. Any differential and more favourable treatment provided under this clause:

- (a) shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties;
- (b) shall not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on a most-favoured-nation basis;

¹ The words "developing countries" as used in this text are to be understood to refer also to developing territories.

² It would remain open for the CONTRACTING PARTIES to consider on an *ad hoc* basis under the GATT provisions for joint action any proposals for differential and more favourable treatment not falling within the scope of this paragraph.

³ As described in the Decision of the CONTRACTING PARTIES of 25 June 1971, relating to the establishment of "generalized, non-reciprocal and non discriminatory preferences beneficial to the developing countries" (BISD 18S/24).

- (c) shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.

(...)

Optional Reading

Jackson pp 157-166

Trebilcock and Howse, 2nd ed., pp 112-116, 119, 127-134

Analytical Index pp 23-62, 789-872