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**THE EU-CHINA RELATIONS AS A PARADIGM OF  
WTO CONTINGENT TRADE PROTECTION  
UNDER THE TRANSITIONAL MECHANISMS**

QINGZI ZANG

A DOCTORAL THESIS SUBMITTED TO DURHAM UNIVERSITY IN  
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## TABLE OF ABBREVIATIONS

ATC	WTO Agreement on Textiles and Clothing
ADA	WTO Agreement on Implementation of Article VI of the GATT 1994 (WTO Anti-dumping Agreement)
ASCM	WTO Agreement on Subsidies and Countervailing Measures (WTO SCM Agreement)
ASEAN	Association of Southeast Asian Nations
CCP	Common Commercial Policy
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
EU	European Union
EC	European Communities
GATT	General Agreement on Tariffs and Trade
LTA	Long Term Agreement Regarding International Trade in Cotton Textiles
MEC	Market Economy Condition
MFA	Multi-fibre Arrangement
NTB	Non-tariff Barrier
NME	Non-marker Economy
OJ	Official Journal of European Union
SGA	WTO Agreement on Safeguards
STA	Short Term Agreement Regarding International Trade in Cotton Textiles
TC	GATT Textiles Committee
T&C	Textiles and Clothing
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TSB	Textile Surveillance Body
TDI	Trade Defence Instrument
VCLT	Vienna Convention on the Law of Treaties
VER	Voluntary Export Restrictions
WTO	World Trade Organisation

# INTRODUCTION

This thesis examines the WTO contingent protection under certain transitional trade mechanisms with a scrutiny of the EU implementing regimes towards China.<sup>1</sup>

## ***Background***

In the context of global trade governance, the legal system administered by the WTO allows two forms of protection: a default protection and state-contingent protection.<sup>2</sup> Under the default protection, WTO Members agree on the bound tariff rates on imported products. No duties in excess of the agreed levels can be imposed in the normal course of transactions. Nonetheless, whenever the agreed contingency emerges, WTO Members are entitled to use contingency trade instruments under which they can increase default tariffs above the ceiling level. Currently, default protection is being gradually reduced through multilateral negotiating rounds, while recourse to contingent protection becomes more frequent and is being gradually rationalised.<sup>3</sup>

Contingency instruments generally consist of safeguard actions, anti-dumping and anti-subsidy duties.<sup>4</sup> The original and continuing importance of such measures, which have by definition trade-restrictive effects, appears hard to reconcile under the GATT/WTO system promoting free trade. Empirical evidence in these areas is consistent with the view that these measures are tools of flexibility to confront difficult situations.<sup>5</sup> The fundamental reason for the

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<sup>1</sup> In this thesis, the term “European Communities” (EC) will be used in the context, event and other relevant issues prior to the Treaty of Maastricht on 1 November 1993. For other discussions, it will be replaced by the term “European Union” (EU) for similar references. Despite the amendments introduced in the Lisbon Treaty, this terminological distinction purely aims to illustrate, in a chronological order, the European policy evolution and its participation in the WTO without any indication regarding the competence allocation therein.

<sup>2</sup> Petros C. Mavroidis, *Trade in Goods: the GATT and the Other Agreements Regulating Trade in Goods*, Oxford University Press, 2007, p.385.

<sup>3</sup> *Ibid*, p.37.

<sup>4</sup> Owing to the limits in length, anti-subsidy measures against domestic subsidy will not be examined in this thesis.

<sup>5</sup> ‘WTO Trade Report 2009: Trade Policy Commitments and Contingency Measures’, available at [http://www.wto.org/english/res\\_e/booksp\\_e/anrep\\_e/world\\_trade\\_report09\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report09_e.pdf), p.13 and p.21. In general, rules under trade agreements have to strike a balance between credible commitments and flexibility. If a trade agreement allows too much leeway to modify

inclusion of such flexibility clauses, i.e. those on anti-dumping and safeguards, in trade agreements is to manage circumstances that cannot be anticipated prior to their occurrence. In the meanwhile, there are another two theories, which are largely complementary, namely the “benefit” approach and the “incomplete contract” approach. According to the former, allowing some degree of discretion to participating governments in setting out their trade policy may serve to improve the rule of law in the trading system and to facilitate trade opening.<sup>6</sup> In fact, contingency measures have often been used to accommodate and isolate protectionist pressure that would otherwise have grown into large-scale threats against the whole policy of openness. For the “incomplete contract” approach, it is held that trade agreements are incomplete by their nature and that flexibilities offer an avenue for dealing with difficulties arising from contractual incompleteness in an agreement.<sup>7</sup> Therefore, a trade agreement that offers such possibilities without unduly weakening existing contractual commitments has a better chance of remaining robust than an agreement that results in regular non-compliance.<sup>8</sup>

The difference between contingency instruments and quantitative restrictions, i.e. import quotas, manifestly derives from many aspects and the former are generally considered as much more legalised measures regulated by the WTO disciplines. However, practical evidence shows that, owing to the same objective of import control, the application of such measures is remarkably influenced by the availability of quotas in the area concerned. Therefore, the examination of contingency instruments also necessitates a policy scrutiny on the quantitative restrictions, which is indispensable in illustrating and explaining the enforcement of the former under the domestic trade regimes.

Under the GATT/WTO system, transitional trade mechanisms have been introduced on several occasions. Two noticeable mechanisms to be investigated in this thesis include the transitional scheme in the sector of textiles and clothing (T&C) and the one affiliated to the WTO membership of China. Insofar as the obligations, the underlying value of the agreement is reduced. But if flexibility provisions are too restrictive, an agreement will be less stable because signatories may be more inclined to renege on their commitments. It is therefore argued that too much flexibility may undermine the value of commitments, but too little flexibility may render the rules unsustainable.

<sup>6</sup> Ibid, p.14

<sup>7</sup> Ibid.

<sup>8</sup> Ibid, p.13

importing countries are concerned, the transitional mechanism on a sectoral or regional basis is negotiated and concluded with the aim of providing sufficient time for domestic preparation and adjustment before the application of liberalised trade policies. Therefore, for the time period during the transition, it usually adopts a permissive approach towards import restrictions and the use of contingency instruments. This has been evidently reflected through the establishment of the special anti-dumping and safeguard devices; in the case of T&C, temporary permission was even granted to quantitative restrictions, which have been conventionally prohibited under the GATT/WTO.

As a noticeable feature, the transitional mechanisms usually entrust national authorities with significant implementation discretion and interpretative flexibility. In contrast with the general WTO contingent regime, which is sketched in the GATT but further elaborated in a separate Annex 1A agreement,<sup>9</sup> transitional instruments in this area are in most cases merely equipped with a brief description of a few provisions. This textual brevity generally necessitates research on the following issues. First, it has to clarify the relationship between the general WTO apparatus and the mechanisms with specific sectoral or regional transitional targets, particularly in the case where different standards are raised and where certain essential provisions are missing in the latter. Second, it is also necessary to define the scope and substance of the national maneuver permitted, or preserved, under such mechanisms. Devolved national powers should be constrained by clearly delineated boundaries. It is simply because abuse of such powers might jeopardise the ongoing sectoral and regional integration process and might also revive protectionism in domestic trade policies.

### ***Research targets***

This thesis, instead of engaging a comprehensive study of the WTO regime of contingent protection, will investigate the operation of the similar instruments under the multilateral transitional mechanisms. However, discussion on other

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<sup>9</sup> For anti-dumping, the relevant WTO rules include Article VI GATT and the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (the ADA); for safeguards, see Article XIX GATT together with the Agreement on Safeguards (the SGA).

transitional strategy during the integration process also goes beyond the scope of this work. Indeed, it will, with the central subject of contingency instruments, develop in-depth scrutiny on, first, the discretionary application of such instruments under the domestic trading regime and its GATT/WTO compliance; and second, their influences upon the overall transitional reform. The insufficiency of relevant research in this area inspires this thesis with the aim of seeking a competent and effective paradigm for the transitional contingent system in the future.

To achieve the above targets, research will focus on the selected subjects. As will be demonstrated in the coming parts that explain the choice of the research subjects, this thesis will be developed in the EU-China context respectively investigating the EU policy enforcement towards China in the T&C sector and under China's special WTO commitments. It is believed that the outcome will benefit not only the ongoing policy negotiation in the sensitive sectors, such as agriculture; moreover, it will also serve the future WTO accessions with two impending cases of Russia and Kazakhstan.

### ***The EU enforcement of contingency instruments***

The EU has been one of the most frequent users of contingency trade instruments. Prior to the 1990s, developed countries, primarily Australia, Canada, the EU and the US, were responsible for up to 98 per cent of all measures, despite the fact that, from the 1990s onwards, developing countries became more active in this area. In the case of anti-dumping, the EU has imposed 258 anti-dumping actions since the establishment of the WTO in 1995, ranking in third place after India with 386 actions and the US with 268 actions.<sup>10</sup>

Based on the practice of many decades, the EU has established a highly developed system in contingent protection that has been followed by many WTO Members. In particular, contingent protection is achieved mainly through the so-called trade defence instruments (TDIs). These instruments allow the EU to defend domestic industries against unfairly traded or subsidised imports and

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<sup>10</sup> WTO Anti-dumping statistics, available at [http://www.wto.org/english/tratop\\_e/adp\\_e/adp\\_e.htm](http://www.wto.org/english/tratop_e/adp_e/adp_e.htm)

dramatic shifts in trade flows, insofar as these are harmful to its economy. The TDI disciplines are generally based on rules derived from the relevant WTO agreements. However, while multilateral agreements have disclosed increased uniformity in trade remedy practices, a high degree of discretion has been granted to the national authorities in deciding a range of important substantive and procedural issues.

### ***Study in the T&C sector***

T&C made up a large share of total international trade, particularly for emerging developing countries such as China and India. Their comparative advantages over the developed countries are manifest leading to a striking trade surplus since the 1950s. In order to protect their domestic industries, most developed countries adopted a rather strict import policy in this sector, which constituted an outstanding exception under the GATT/WTO system. The sectoral liberalisation process will be discussed in detail in the subsequent chapters. Here, suffice it to say that the T&C is the last industrial sector integrated into the multilateral trading system of the GATT, which, until 2008, had been consistently regulated by a series of transitional trade regimes.<sup>11</sup> The following features of this sector have attracted most research interest in this thesis.

First of all, the sector-specific regime tolerated a wide use of trade restrictions. It followed a very permissive approach towards quantitative restrictions. Indeed, this sector was fraught with numerous national import quotas, the use of which has been expressly outlawed in other industrial sectors. With regard to the contingency instruments, transitional safeguards, which, compared with the SGA, considerably facilitated the restriction imposition in the importing country, were known as one prominent feature of the T&C regime. In the area of anti-dumping, this sector has been one of the most frequent targets since the 1970s. Therefore, the transitional mechanisms in T&C constitute an adequate research subject in contingent trade policy, particularly with regard to the interaction between quantitative restrictions and contingent measures, policy preference

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<sup>11</sup> In particular, this sector has successively experienced four multilateral systems, namely the short-term arrangement in cotton textiles (STA), the long-term arrangement in cotton textiles (LTA), the Multi-fibre Arrangement (MFA) and the WTO Agreement on Textiles and Clothing (ATC).

among different instruments, as well as their influence upon the sectoral integration process.

Second, T&C is a highly political-sensitive sector of the EU owing to the diverse interests among manufacturers, consumers, retailers, as well as the Member States. In the past 30 years, the European T&C industries have witnessed significant restructuring and modernisation, which have led to remarkable interest relocation and new market concentration. The Member States with different economic orientation also present contrasting positions in the EU-wide sectoral policies. A T&C sectoral study will thus not only contribute to demonstrating the interaction between domestic demands and international commitments during the policy formulation process; moreover, it will also evaluate the frequent use of the TDIs in terms of the overall interest of the EU.

Third, in the EU-China context, the T&C issue has become one of the most controversial trade topics. While the EU was one of the traditional restriction-imposing countries until 2005, China has been acting as the top exporter for decades. During the WTO accession, enormous concerns arose with regard to its export potential in this sector, which eventually led to the establishment of the transitional safeguards exclusively applicable to Chinese T&C products until 2008. Therefore, the sectoral policy evolution between these two leading players and its influence upon the overall bilateral trade relations deserve in-depth investigation.

### ***The transitional mechanism under China's WTO membership***

In contrast to the dominant role of the EU as a frequent user of contingency instruments, the involvement of China is equally significant on the receiving end. During the period of 1995 – 2008, 479 anti-dumping actions were imposed against its imports, taking up to 21.9 per cent of the total amount worldwide.<sup>12</sup> The EU was responsible for 60 of them, with India imposing 90 restrictions and 66 from the US. Among the 138 anti-dumping measures reported in 2008, China

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<sup>12</sup> Ibid.

was targeted in 52 proceedings. Hence, it is not disputed that China has been the world's biggest target in contingent protection.

Such practice is mainly due to the operation of the discriminatory trade policies towards China as a non-WTO member; and thus, prospects of improvement in this regard were confidently expected upon China's accession to the WTO. However, owing to the additional commitments established in the accession documents, namely, the Protocol on the Accession of the People's Republic of China (the Accession Protocol) and the Report of the Working Party on the Accession of China (the Working Party Report), the situation has hardly changed so far. In particular, under the transitional mechanism established therein, the unfavourable pre-WTO practice in anti-dumping, safeguards and anti-subsidy continues and there is no *prima facie* evidence that WTO membership has limited the use of these instruments.

Two changes nonetheless have emerged. First, the WTO confirms the transitional nature of the special treatment and thus sets forth fixed deadlines thereof. For instance, the special anti-dumping and safeguard mechanisms will expire respectively 15 and 12 years after the accession, which will then be replaced by provisions under the relevant WTO agreements. Second and more importantly, as part of the WTO commitments, such treatment is no longer an issue entirely subject to national autonomy as it used to be. Instead, there should be now the WTO standards in the light of which the application of contingency instruments against China can be evaluated. It thus becomes necessary to delineate the relevant multilateral constraints imposed upon the domestic practice accordingly.

So far, more and more WTO Members, owing to economic and political considerations, have chosen to renounce this privilege over China and developed the bilateral trade relations on a pure GATT basis.<sup>13</sup> However, the EU stands as a noticeable exception maintaining mainly untouched its China-specific regime dating back to the 1970s. Since the establishment of the bilateral trade relations, the EU has been running a China-specific trade regime that dramatically

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<sup>13</sup> Until July 2009, 57 countries worldwide have granted China the overall market economy status. In the anti-dumping proceedings, 21 out of 31 of the countries imposing anti-dumping measures against Chinese imports have abandoned the discriminatory treatment.

deviates from the treatment of imports from other sources. This special regime is the outcome of several combined reasons, such as the nature of China's economy structure which historically was centrally planned and the capacity of its manufacturing exports which, in the recent decades, noted potent increase. In many ways, more restrictive trade policies have been followed, which are essentially reflected in the use of the TDIs. Therefore, the EU, being one major policy executor of contingent protection worldwide as well as the biggest trading partner of China, constitutes an important subject to examine the implementation of the China-specific contingency instruments.

## ***Structure***

Chapter I starts with the study on the transitional trading systems in T&C, namely the Multi-fibre Arrangement (MFA) and the WTO Agreement on Textiles and Clothing (ATC), respectively initiated in the 1970s and the 1990s. As sectoral exceptions to the general trading system, their interaction and relationship with the GATT/WTO have to be clarified from the outset. Essentially, it concerns the question of what rules should apply when it comes to the T&C sector and how to reconcile the normative conflicts between them. Owing to the marked policy overlapping and conflicts, this issue is of particular importance in the field of contingent protection. Subsequent to the preliminary discussion on the applicability of trading rules, discussion will move on to the legal framework under the T&C mechanisms with major focus on the disciplines regarding import quotas, transitional safeguards, as well as the relevant measures for sectoral liberalisation.

It is important to note that the primary target of the transitional regimes is to achieve the overall integration of T&C through temporarily legitimising selected protectionist instruments. In other words, rather than intensifying the existing restrictions, the MFA and the ATC were negotiated and concluded with the aim of furthering free trade. Thus, in order to examine the functioning of the contingent mechanisms, it has to first look into the general policy apparatus that they are embedded. Such an overall assessment of the transitional policies essentially answers the questions as to how the trade-restrictive instruments, i.e.

quotas and safeguards, interact with each other and what are their impact upon the reform progress and achievements in the light of the sectoral integration target.

The influence of the MFA and the ATC upon the global trade, together with the achievement of the transitional mechanisms in T&C, will conclude the first chapter. In a nutshell, Chapter I attempts to reveal the role of the contingency measures during the transition period of a specific sector and their influence, either positive or negative, upon the reform towards free trade.

Chapter II examines the external trade policies of the EU, including not only policy analysis in the general term but also specific exploration of the sectoral issues of T&C. The Common Commercial Policy (CCP) represents the legal basis for the EU to trade with the rest of the world, which will be introduced with particular emphasis upon the commercial instruments entrusted thereunder. From the external perspective, WTO law constitutes the most widely used legal framework in international trade and has acquired a central role in the formulation of the EU's internal and external policies. Therefore, the impact of the WTO will be investigated in detail, especially with regard to its enforcement in the EU and its relationship with the EU law.

For the T&C sector, following the discussion in the previous chapter, Chapter II will investigate the EU enforcement of the international transitional disciplines. It will explore, first, the application of quotas and safeguard measures, and second, the manipulation of the policy flexibilities permitted under the MFA/ATC.

In general, the EU T&C regime was mainly founded upon three threads: the multilateral framework under the MFA and the ATC, the bilateral agreements with the supplier countries, and the autonomous import legislation separated from other industrial sectors. In the analysis of the bilateral T&C agreements, Chapter II will investigate the specific sectoral instruments established thereunder, namely the special safeguard system and the quota sub-division among the Member States. For the autonomous legislation, discussion will be based on combined consideration of the following elements: the evolution of

international T&C disciplines, national discretion preserved under the transitional mechanisms, and development in domestic industries and market. In particular, it attempts to define the performance of each element in the process of policy formulation and to identify the major determinant pushing either for more liberalised sectoral policy or for frequent recourse to contingent protection and restrictions in other forms. The central objective thereof is to find out what is the principal driving force of the EU policy development during the T&C transitional reform.

Chapter III will move on to the transitional mechanism affiliated to the WTO membership of China. As part of the additional commitments stipulated in the accession documents, the special contingency instruments have attracted most controversy. This chapter will first rationalise the relationship between the WTO agreements and the accession documents. In this regard, recent WTO disputes involving China have already disclosed certain interpretation difficulties and an explicit response from the Dispute Settlement Body (DSB) is still forthcoming. Afterwards, the main part of this chapter will provide a detailed scrutiny of the China-specific contingency instruments.

The accession documents specify three apparatuses in this regard: the non-market economy (NME) treatment in anti-dumping and anti-subsidy, the product-specific safeguards, and the T&C-specific safeguards. Compared with similar measures under the GATT, the transitional instruments towards China are subject to significantly different requirements and obligations in both the substantive and procedural terms. This necessitates an in-depth study of the features of these instruments and the potential obstacles pertaining to their interpretation and implementation. Particular attention will be paid to the definitions of the new terms raised in the transitional mechanisms and the deviating points from their counterpart instruments under the WTO.

Furthermore, another research focus lies in the textual vagueness, lack of regulatory precision, and the consequent discretion permitted in the implementing process. Indeed, there is a clear trend of bilateralism and marked policy flexibilities under the China-specific contingent mechanisms, which might nevertheless risk policy discrepancy or even regression between China

and certain Members and thus jeopardise the overall integrity of the WTO system.

For the T&C sector, questions to be answered include: what compromise, in terms of the trading right awarded by the WTO membership, China has made under the T&C safeguards; and more importantly, whether this instrument has proven to be a well-functioning mechanism in view of the sectoral liberalisation parade dating back to the 1950s.

The preceding inspection of the contingency instruments will be followed by the concluding remarks of this chapter envisaging the prospective policy development until the expiry of the transitional mechanisms in 2016.

Based on the analysis of China's special commitments at the WTO, Chapter IV will investigate their enforcement within the EU. Similar to the research aims of Chapter II, principal discussion will focus on EU's interpretation and implementation of the transitional contingency instruments, the problems that have emerged in practice and their potential impact upon the overall transition process.

In the anti-dumping proceedings, the EU defines China as an economy in transition and established three possible methodologies in the investigation, namely the market economy treatment, the NME treatment, and the individual treatment. This chapter will explain each treatment on the basis of the relevant EU legislation, as well as the jurisprudence of the European Court.

As mentioned earlier, in spite of the WTO permission for the use of NME treatment towards China, the major importing Members have gradually abandoned this discriminatory practice, except India, the US and the EU. However, it is highly questionable whether the current EU practice is in full compliance with the provisions under the accession documents, especially its manipulation of the national discretion permitted thereunder. Experience so far has already shown a number of policy deficiencies, which indeed requires a dedicated survey for the appropriate resolutions.

Insofar as imports from China are concerned, the current EU safeguard regime consists of three mechanisms, which respectively implement the standard WTO safeguards, the transitional product-specific safeguards and the T&C-specific safeguards. The co-existence of these mechanisms and the possibility of “policy shopping” raise doubt as to whether it is entirely up to the EU to choose any of the mechanisms it considers most suitable when the emergency situation arises. Indeed, as one major TDI, safeguards are much less used in practice and the preference for anti-dumping is manifest.<sup>14</sup> Nevertheless, 2005, shortly after the overall opening of the T&C market, witnessed the most notable safeguard operation of the EU against certain textile products from China. As one of the few safeguard proceedings, the application process will be investigated in detail in the context of Para 242.

The final part of Chapter IV will elaborate two particular issues under the EU TDI practice, namely the policy preference among different instruments and the application of the Community interest clause. Discussion in this part applies to the general WTO contingency measures and those under the transitional mechanisms alike. First of all, the prevalence of anti-dumping over safeguards constitutes one of the “real-world” issues. On the one hand, the advantages of safeguards have been widely supported by economic and legal commentators; on the other hand, this theoretic advancement has been spurned by most importing countries, including the EU. The concluding section will seek to explain this paradox and explore the elements involved in the decision-making process.

Furthermore, as one major EU innovation in contingent trade protection, the Community interest clause is required in most TDI investigations. The main aim of this clause is to make sure that the enforcement of a particular TDI is unbiased and beneficial in terms of the overall Community interest. Particularly, it can be used to block a TDI from being adopted if the damages caused overrule the benefits received. However, this clause has been criticised for its limited

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<sup>14</sup> So far, the EU has merely imposed four WTO safeguard measures in total and none of them proceeded under the product-specific safeguards against China. In the safeguard proceeding on imports of citrus fruits in 2003, the investigation was opened under both the WTO and the transitional product-specific safeguards. As the WTO safeguards were considered by the EU to be sufficient to eliminate the injury caused to the domestic industry, the latter was consequently closed.

influence and the outcome of the assessment rarely goes against the proposed measures. Research in this regard will examine the current practice under this clause and verify whether it has worked as an “effective filter” in the TDI enforcement. Indeed, it is closely linked to the fundamental question as to whether the frequent use of TDI is able to serve the best interest of the EU.

Hence, in Chapter IV, EU’s TDI enforcement towards China will be examined in terms of both the substantive WTO provisions and the fundamental principles underlying the contingent protection regime. Apart from identifying and revealing the policy deficiencies and the WTO violations under the current practice, proposals and resolutions will also be made for future improvement. Moreover, this chapter also aims to verify certain preliminary conclusions reached in the previous T&C discussion, such as the poise between domestic demands and international obligations and the substitute application among different contingency instruments.

In the last chapter, the concluding remarks will summarise and further develop the observations arising from the preceding chapters. Based on the marked policy discretion identified under the transitional mechanisms, the remarks will comment on its consequent influence in the EU implementation process, including the instrument substitution in trade management, policy delay in the transitional reform and the indulgence of domestic demands in the policy formulation process. It is argued that the policy discretion, as envisaged in the relevant GATT/WTO provisions, has to be more cautiously curbed in the future practice. The increased surveillance should highlight first, more disciplined application of the contingency instruments, and second, strengthened commitments in the overall liberalisation strategy. While the latter issue requires specific study in the area under transition and is thus open for future research, the resolutions and proposals towards unbiased use of contingency instruments will be provided in this thesis.

## **CHAPTER I. DEVELOPMENT OF THE TRANSITIONAL MECHANISMS IN TEXTILES AND CLOTHING**

The T&C sector has been regulated separately from other industries since the early stages of the GATT. Despite the prevailing sectoral protectionism, the reform process toward trade liberalisation started in the 1950s, which had combined the long-term target of free trade, on the one hand, and practical needs for short-term sectoral protection, on the other. This chapter will look into this process and explore the sector's eventual assimilation into the GATT/WTO system.

The ensuing parts will examine the two significant trade regimes in T&C, namely the MFA and the ATC. For each regime, the discussion will focus on the following issues: the interaction between the sectoral regime and the generally applicable GATT/WTO rules; the T&C-specific provisions, especially with regard to quantitative restrictions and contingent trade instruments; the reform process toward trade liberalisation and the balance made between market opening and industrial demands for sectoral protection.

### ***Section I. The MFA domination***

By the 1950s, the cotton industry of the industrial countries was facing the problem of cheap imports from the low-cost countries. A discussion on multilateral rules for trade in cotton products took place at the insistence of the US. These negotiations culminated in the emergence of the Short Term Agreement Regarding International Trade in Cotton Textiles (STA) and its successor, the Long Term Agreement Regarding International Trade in Cotton Textiles (LTA) for cotton products until 1973. These two agreements were fairly similar in substance and devised as a temporary departure from the GATT rules to allow the participating industrial countries to restructure their textile industry. This mandate was especially reflected in two articles legitimating the existing non-tariff restrictions on less-developed country exports of cotton textiles. The first one referred to Article 3, which allowed individual countries to take safeguard measures in the case of market disruption. This sector-specific mechanism deviated from the fundamental GATT rules of non-discrimination and was characterised by its selective application. In the meantime,

Article 4 further set forth the conclusion of bilateral agreements in this area provided they were in line with the main objectives and principles of the STA/LTA. In contrast to the multilateral approach promoted under the GATT, the sector of cotton textiles noted manifest preference for bilateralism. As will be analysed later, these two Articles were inherited in the succeeding system of the MFA and maintained to be the primary features of the sector-specific trading regime.

After operating for some time, the major importing countries considered that the structure of these cotton rules was too narrow in scope and that difficulties arising in other sectors of their textile market called for a broadening of the arrangement. Consequently, negotiations within the GATT framework, which aimed to apply the existing rules more broadly, started in 1973 and eventually resulted in the establishment of the MFA. The draft, which was accepted by almost 50 countries, was completed at Geneva on 20 December 1973 and came into force on 1 January 1974, replacing the previous STA and the LTA on cotton textiles.

In general, the MFA was primarily motivated by an imbalance in the world trade in textiles. Rather than being limited to cotton products, it extended to wool and artificial and synthetic fibres. For this reason, it came to be known as the “multi-fibre” agreement. Although originally designed for a period of four years, the MFA was repeatedly extended until the end of 1994. The series of renewals took place respectively in December 1977, December 1981, July 1986, July 1991, December 1992 and December 1993.<sup>15</sup>

A number of commendable objectives in terms of sectoral liberalisation were established in the MFA.<sup>16</sup> First, the MFA was intended to promote and liberalise the world trade in textiles while at the same time avoiding market disruptions in the importing countries. Second, it also took into account the prevailing conditions in developing countries and the need to secure a substantial increase in their textile

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<sup>15</sup> For the text of the MFA, see OJ, L 118, 30/04/1974, p.1-10.

<sup>16</sup> According the wording under Art 1 of the MFA, the basic objectives shall be to achieve the expansion of trade, the reduction of barriers to such trade and the progressive liberalisation of world trade in textile products, while at the same time ensuring the orderly and equitable development of trade and avoidance of disruptive effects in individual markets and on individual lines of production in both importing and exporting countries. A principal aim in the implementation of this arrangement shall be to further the economic and social development of developing countries and secure a substantial increase in their export earnings from textile products and to provide scope for a greater share for them in world trade in these products.

exports. The major provisions under this agreement included Article 2 on quantitative restrictions, Article 3 on special safeguard measures, Article 4 on bilateral textile agreements, Article 8 on the prevention of circumvention and Articles 10 and 11 on the establishment of institutional bodies.

During the negotiation stage, the main concern was the gradual removal of the existing quantitative restrictions imposed in this sector, ranging from unilateral quantitative restrictions, quotas under the bilateral agreements, to other measures with similar trade-restrictive effect. In fact, it has been widely accepted that, as trade instruments, tariffs have more positive influence in terms of the sustainable economic growth. First, quantitative restrictions are considered to be less [economically efficient](#) in that they permit the local market to be sealed off to the desired extent from the discipline of the world market. Once the quantity of imports provided for in a restriction has been reached, no degree of increased efficiency in exporting countries or decreased efficiency in the importing country could lead to greater imports. Thus, the efficiency-maximising function of international trade is frustrated to a much greater degree by quantitative restrictions than by tariffs.<sup>17</sup> Second, it is also argued that quantitative restrictions usually lead to reduced transparency management in trade control. Whereas a departure from non-discriminatory tariffs could be relatively easily verified, quantitative restrictions might be linked to hidden discriminatory application, since administrative discretion normally played a major role in their management.<sup>18</sup>

In this regard, Article 2 MFA provided that the existing quantitative restrictions had to be notified to the relevant institution, and had to be progressively withdrawn thereafter, unless they were included in a programme of progressive elimination scheduled for completion by 31 March 1977, or justified under the safeguard clause under Article 3, or imposed by virtue of bilateral agreements negotiated as provided in Article 4. Furthermore, Articles 3 and 4 regarding the sector-specific safeguards and the bilateral textile agreements constituted the principal MFA provisions dealing with quantitative restrictions, covering both the existing import quotas from the STA/LTA era and the new restraints to be introduced under the MFA. Therefore, the general MFA approach towards quantitative restrictions was, unless justified by the

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<sup>17</sup> Kenneth W. Dam, *The GATT: Law and International Economic Organization*, University of Chicago Press, 1970, p.148-149.

<sup>18</sup> *Ibid.*

relevant provisions of either the GATT or the MFA, that all existing measures mentioned above should be terminated; and in the meantime, no new restrictions should be introduced nor should existing restrictions be intensified. At first glance, this approach appeared quite far-reaching in the target of sectoral liberalisation; however, through a detailed scrutiny, it is revealed that, around that time, protectionism was still the mainstream policy in this sector.<sup>19</sup>

Therefore, in contrast to the flat prohibition on quantitative restriction under Article XI:1 GATT,<sup>20</sup> the situation under Articles 2, 3 and 4 MFA turned out to be an outstanding exception; and under several circumstances such restrictions were permitted in the textile sector.

Article 8 was another important provision in the MFA, which concerned the prevention of circumvention. According to that Article, annual quotas, as well as quantitative restrictions in other forms, might be circumvented through trans-shipment, re-routing, or action by non-participants; thus consultations with a view to seeking promptly a mutually satisfactory solution were envisaged thereunder. In the case where agreement cannot be reached during the consultation process, the importing country could resort to actions under Articles 3 and 4. In other words, under this circumstance, Article 8 entitled the importing country to take unilateral action in the form of safeguard measure or previous agreed resolution to cope with the ongoing quota circumvention.

Articles 10 and 11 established two institutional bodies under the MFA: the GATT Textiles Committee (TC) and the Textile Surveillance Body (TSB). The major role of the TC included conducting studies and reporting annually to the GATT Council. It also had the authority to interpret the MFA provisions and to issue opinion in the disputes among the contracting parties. Furthermore, the TC was entrusted with the task of establishing the TSB, the main responsibility of which was to review and report on the unilateral restraints and bilateral agreements adopted pursuant to the MFA. With regard to the dispute settlement, the power of the TSB was nevertheless

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<sup>19</sup> For detailed discussion, see Sections 1.2 and 1.3.

<sup>20</sup> Article XI GATT provides that “no prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party”.

limited to making non-binding recommendations and to expressing its view when the disputes were referred to it.<sup>21</sup>

The following section will examine the trade restrictions under the MFA. In practice, most quotas were either imposed as safeguard measures under Article 3 or specified in the bilateral agreements under Article 4. Both articles will be explored in detail, especially in terms of their inherent nature and effects in the sectoral liberalisation process. To start with, the coming discussion will first look into the interaction and legal relationship between, on the one hand, GATT 1947 and, on the other hand, the MFA, which was viewed as a sub-regime exception of the former.

### **1.1 The relationship between the MFA and GATT 1947**

The legal relationship between these two systems has never been clearly defined.<sup>22</sup> First of all, the MFA was a constituent part of the GATT system. Dating back to the conclusion of the MFA, a report containing the text of this arrangement was adopted by the GATT Council in January 1974 and the CONTRACTING PARTIES implicitly agreed to the MFA by adopting the annual report of the Council. The adoption of the annual report belonged to a joint action under Article XXV of the GATT;<sup>23</sup> in particular, Article XXV provided that representatives of the contracting parties shall meet from time to time for the purpose of giving effect to those provisions of the Agreement which involve joint action and, generally, with a view to facilitating the operation and furthering the objectives of the Agreement.<sup>24</sup> Hence, as a joint action by the CONTRACTING PARTIES, the MFA shall be recognised as part of the GATT legal order.<sup>25</sup>

The second aspect of the legal relationship concerns the hierarchy between these two sets of trading rules. This issue is particularly linked to the question how, as part of the GATT, could the MFA provisions apply together with the GATT rules in the field of textiles. On the one hand, it has to be pointed out from the outset that there is,

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<sup>21</sup> Articles 10 and 11 MFA.

<sup>22</sup> GATT Document MDF/W/22 (1985), available at [http://www.wto.org/gatt\\_docs/English/SULPDF/92250057.pdf](http://www.wto.org/gatt_docs/English/SULPDF/92250057.pdf).

<sup>23</sup> Niels Blokker, *International Regulation of World Trade in Textiles: Lessons for Practice a Contribution to Theory*, Martinus Nijhoff Publishers, 1989, p.250.

<sup>24</sup> Article XXV GATT 1947.

<sup>25</sup> Niels Blokker, n.9.

generally speaking, no inherent hierarchy in the sources of norms under public international law.<sup>26</sup> This is a direct consequence of the assumptions that all international norms derive from state consent and that states, as creators of law, are equal to each other. Since all norms essentially derive from the same source, it is thus presumed that they have the same binding value. Therefore, unlike most domestic legal systems, a norm derived from one source of international law is not of higher value than a norm formed under another source based on the organ creating the norm or the procedure followed.<sup>27</sup> Regarding international trade in textiles, although negotiated and concluded within the framework of the GATT, the MFA was not a subordinate part thereunder. Rather, as two norms of international law, they were born with the equal legal standing and no priority could be attributed to one over the other.

On the other hand, there is nevertheless an informal hierarchy, which, rather than following from legislative enactment, emerges pragmatically as a natural aspect of legal reasoning.<sup>28</sup> In fact, provisions under the MFA enjoyed certain priority over the GATT rules in the course of application when dealing with the particular situations in the sector of textiles. In the context of international law, when there exists more than one rule that is *prima facie* applicable to a given situation, the choice between them can be made by the application of one or other of two principles, namely, *lex specialis derogat generali* and *lex posterior derogat priori*, which mean that the special rule overrides the general rule and the later rule overrides the earlier rule.<sup>29</sup>

The maxim *lex specialis* is a generally accepted technique of interpretation and conflict resolution in international law. It suggests that whenever two or more norms deal with the same subject matter, preference should be given to the norm that is more specific. This prevalence is justified by the fact that such special law, being more concrete, often takes better account of the particular features of the context in which it is to be applied than any applicable general law. Its application may also

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<sup>26</sup> Three exceptions could nevertheless be identified, which refer to obligations *erga omnes*, the *jus cogens* under Article 53 VCLT and Article 103 of the UN Charter.

<sup>27</sup> Joost Pauwelyn, *Conflict of Norms in Public International Law: how WTO law Relates to Other Rules of International Law*, Cambridge University Press, 2003, p.94.

<sup>28</sup> 'Fragmentation of international law: difficulties arising from the diversification and expansion of international law', Report of the Study Group of the International Law Commission, finalised by Martti Koskenniemi, para. 251, available at <http://daccessdds.un.org/doc/UNDOC/LTD/G06/610/77/PDF/G0661077.pdf?OpenElement>.

<sup>29</sup> Malcolm D. Evans, *International Law*, Oxford University Press, 2006, p.136.

often create a more equitable result and it may better reflect the intent of the legal subjects.<sup>30</sup> In the *Legality of the Threat or Use of Nuclear Weapons* case (1996), the International Court of Justice observed that both human rights law, namely the International Covenant on Civil and Political Rights, and the laws of armed conflict applied “in times of war”. Nevertheless, when it came to determine what was an “arbitrary deprivation of life” under Article 6 (1) of the Covenant, this fell “to be determined by the applicable *lex specialis*, namely the law applicable to armed conflict”.<sup>31</sup> In the MFA-GATT context, the applicability of the *lex specialis* principle is based on the premise that the MFA provided for trading rules with particular focus in the textile sector while the GATT rules were designated to regulate international trade in goods from almost all the industries.

With regard to the principle of *lex posterior*, Article 30 (3) of the Vienna Convention of Law of Treaties (VCLT) provides that when all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty. Insofar as the international treaty could be deemed as an expression of the state will, a later expression of the state will logically prevail over an earlier one. In other words, later law supersedes earlier law since the former reflects more concretely present circumstances and the present will of the relevant actors. In the *Mavrommatis Palestine Concessions* case (1924), the Permanent Court of International Justice applied *lex posterior*, together with *lex specialis*, on the issue of the relationship between the Mandate Treaty for Palestine of 1922 and Protocol XII of the Peace Treaty of Lausanne of 1923. The Court stated that: “in cases of doubt, the Protocol, being a special and a more recent agreement, should prevail”.<sup>32</sup> As to the conflict resolution, the *lex posterior* principle is at its strongest in regard to conflicting or overlapping provisions that are part of treaties that are institutionally linked or otherwise intended to advance similar objectives, i.e. form part of the same regime.<sup>33</sup> This inherent strength precisely suits the MFA-GATT interaction. Because the MFA was negotiated and concluded within but chronologically after GATT 1947,

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<sup>30</sup> ‘Conclusions of the work of the Study Group on the fragmentation of international law: difficulties arising from the diversification and expansion of international law’, *Yearbook of the International Law Commission*, (2006) II, Part Two, p. 3-4.

<sup>31</sup> *Legality of the Threat or Use of Nuclear Weapons*, Advisory opinion, I.C.J. Reports 1996, p. 240, para. 25.

<sup>32</sup> *Mavrommatis Palestine Concessions*, P.C.I.J. Series A, No. 2 (1924), p. 31.

<sup>33</sup> ‘Conclusions of the work of the Study Group on the fragmentation of international law: difficulties arising from the diversification and expansion of international law’, n. 16, p. 9-10.

its prevalence shall be confirmed over the latter.

## **1.2 The MFA safeguard mechanism**

The special trading regime had been maintained in effect for more than 30 years before the T&C sector was eventually integrated into the GATT/WTO at the beginning of 2005. The contingent safeguards constituted the most important part of the sector-specific regime.

Under the MFA, the safeguard mechanism was established in Article 3. It was generally based on the safeguard provisions under the previous STA and LTA but with expanded application scope. In particular, Article 3 provided that “the participating countries agree that this article should be resorted to only sparingly and its application shall be limited to the precise products and to countries whose exports of such products are causing market disruption as defined in Annex A taking full account of the agreed principles and objectives set out in this arrangement and having full regard to the interests of both importing and exporting countries”. Accordingly, if, in the opinion of the importing country, its market is being disrupted by imports of certain textile products not subject to restraint, it shall seek consultations with the exporting country or countries concerned with a view to removing such disruption. Furthermore, it was also provided that after a period of 60 – day consultation, in the case that there had been no agreement either on the request for export restraint or on any alternative solution, the requesting country may decline to accept imports from the participating country or countries of the textiles imports causing market disruption.<sup>34</sup>

It is thus clear that the MFA safeguards possessed two distinguishable features. First of all, “market disruption” constituted the substantive threshold to trigger a safeguard, which marked a considerable deviation from the prevailing safeguard benchmark of “serious injury”.<sup>35</sup> The other feature refers to the selective application of the restraint and the lack of compensation or retaliation on the part of exporting countries. In fact, the latter is also shared among the subsequent sector-specific

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<sup>34</sup> Article 3 MFA.

<sup>35</sup> In fact, the same term was employed later again in China’s WTO accession documents, but the definition varied dramatically and the explicit discrimination against low-priced exports was also dropped. For detailed discussion, see Chapter III Section II.

safeguards in T&C.<sup>36</sup>

### **1.2.1 Substantive requirements: market disruption vs. serious injury**

Under the MFA, the term “market disruption” represented the deciding element for the imposition of safeguard measures. The origin of this term dates back to 1959 when the CONTRACTING PARTIES of the GATT decided, upon the initiative of the US, to adopt a decision concerning steps to be taken for avoiding market crisis. To a certain extent, the growing interest in this regard reflected a search for a legal justification for the retention of quantitative restrictions.<sup>37</sup> As stipulated in Annex A of the MFA, the determination of “market disruption” shall be based on the existence of serious damage to domestic producers or actual threat thereof; and must demonstrably be caused by certain factors stipulated clearly in that Article, rather than other instrumental ones, such as technological changes or changes in consumer preferences. The factors causing market disruption, which generally appear in combination, include, first, a sharp and substantial increase or imminent increase of imports of particular products from particular sources; and second, import prices which are substantially below those prevailing for similar goods of comparable quality in the market of the importing country.<sup>38</sup>

Although referring to the same benchmark as the general GATT safeguards - serious injury to domestic industries or actual threat thereof - the MFA put forward further requirements with regard to the causal factors of the injury. As mentioned earlier, the sale of products at a price below average was deemed as a signal of market disruption under the MFA.<sup>39</sup> While the serious injury under Article XIX GATT is mainly based on the “unforeseen developments” in the increased quantities of the imports concerned, the MFA highlighted the existence of the low-priced trade practice as an essential factor in proving market disruption.

This MFA position towards the low-price sales differed markedly from the GATT

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<sup>36</sup> Article 6 ATC, Para 242 of the Working Party Report. For detailed discussion, see Chapter I Section 2.4 and Chapter III Section III.

<sup>37</sup> Kenneth W. Dam, n.3, p. 298.

<sup>38</sup> This definition is nevertheless criticised for its textual vagueness: no indication was given regarding the criteria for determining damage to domestic producers and the list of these criteria in Annex A was not exhaustive. Moreover, the two factors in Annex A allowed for subjective interpretations. Niels Blokker, n.9.

<sup>39</sup> Annex A MFA.

practice. In the GATT context, the low price of products is considered as the major advantage gained by the developing countries. Imports of such products are not discriminated from others that are normally priced; and no special trading rules have been imposed in this regard. In most cases, they are generally considered as legitimate competition and are thus exempted from quantitative restrictions.<sup>40</sup> In contrast, the MFA adopted an opposite approach: the low-priced imports were stringently restricted and would probably face limitations from the importing country. Even more problematic, there was no attempt to set forth the relationship that must exist between the prices of the allegedly disruptive imports and those of the third country imports before a finding of market disruption can be justified.<sup>41</sup> That is to say, the meaning of substantial price difference, as required under the MFA, was unanswered, which has been so liberally construed by the importing countries that any increase in imports has been viewed as justifying a restraint order.<sup>42</sup>

### **1.2.2 Application issues: global restrictions vs. regional quotas**

Safeguard mechanisms under the MFA and GATT could also be distinguished from each other through the scope of action: while measures under Article XIX GATT take the form of global restrictions, those under Article 3 MFA referred to regional quotas only.

Owing to the principle of non-discrimination, the GATT safeguards had to apply in an identical manner across the board and selective application was not allowed among the Members. Although Article XIX itself did not make any reference to the prohibition on selective application, a non-discriminatory interpretation of this Article found a solid basis in the 1980 *Norway—Hong Kong* textile report.<sup>43</sup> The GATT panel in that case was of the view that that type of action chosen by Norway,

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<sup>40</sup> Under the GATT system, they would be restricted under only two circumstances. The first case where low-priced products would be limited is the so-called illegal trade practice, i.e. the dumping or the subsidy. Under these situations, imports will be restricted through the enforcement of the anti-dumping or the countervailing measures, in accordance with the relevant GATT rules. The second situation is concerned with trade emergency, which requires the adoption of safeguard measures. In this case, the GATT safeguard mechanism under Article XIX will intervene in order to provide the protection for the domestic industry in importing country Members. Consequently, if low-priced imports do not result from illegal trade practice and, at the same time, the conditions under Article XIX on safeguards are not met, these imports should be tolerated by importing countries and considered GATT/WTO-compatible.

<sup>41</sup> Kenneth W. Dam, n.3, p. 303.

<sup>42</sup> *Ibid*, p. 312.

<sup>43</sup> *Norway – Restrictions on imports of certain textile products*, BISD 27S/119.

i.e. quantitative restrictions, limiting the importation of the nine textile categories in question, as the form of emergency action under Article XIX, was subject to the provision of Article XIII which provided for non-discriminatory administration of quantitative restrictions.<sup>44</sup> Since then, it is the established GATT principle that the requirement of non-discrimination should apply to all safeguard measures imposed. In contrast, the MFA safeguards were applied on a selective or regional basis, which means not all the exporting countries supplying the same product would be affected except those considered by the importing country as the cause of market disruption.<sup>45</sup>

Furthermore, indication of selective application also arises from the prohibition on low-priced sales, which indeed rendered the MFA safeguards to be imposed mainly against imports from developing countries. Even if the condition against low-priced practice applied across the board, it *de facto* circumscribed the targets of MFA safeguards mainly among developing exporters.<sup>46</sup> This is because low wages and low-priced exports are the major comparative advantages and the principal means of competition particularly, if not exclusively, for those countries. In other words, if MFA safeguards were targeted at the inexpensive exports, goods from developed countries would hardly be affected, if at all;<sup>47</sup> and developing countries, without doubt, turned out to be the only group that suffered. It thus discloses a systemic clash within the MFA. On the one hand, Article 1 MFA explicitly established the reduction of trade barriers as one of the basic objectives, which essentially pointed to the quantitative restrictions imposed against exports from developing suppliers. On the other hand, however, the negotiators designed such a “safety valve” in Article 3 that particularly targeted exports from the same sources.

Another application issue to be discussed concerns the contemplated safeguard actions envisaged under the MFA and the GATT. The term “contemplated safeguard actions” refers to those which could be enforced unilaterally in the situation where no mutually acceptable resolution could be achieved during the consultations. According to Article XIX GATT, the importing contracting party shall be free to suspend the relevant obligation in whole or in part or to withdraw or modify the

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<sup>44</sup> Ibid, para.15.

<sup>45</sup> Article 3.2 MFA.

<sup>46</sup> Yong-Shik Lee, *Safeguard Measures in World Trade: the Legal Analysis*, Kluwer Law International, 2003 p.119.

<sup>47</sup> Niels Blokker, n.9.

concession in respect of the product, to the extent and for such times as may be necessary to prevent or remedy such injury. That is to say, in the absence of agreed resolution by the end of consultations, the importing GATT Member is entitled to make its own decision regarding the means of safeguarding the domestic industry concerned.<sup>48</sup>

Article 3 MFA, however, explicitly stipulated the form and extent of the contemplated safeguards. In particular, it provided that, in the case where no agreement is achieved, the requesting participating country may refuse the textile imports concerned in excess of a fixed level, not less than the one provided for in Annex B, for 12 months beginning on the day of the request for consultation.<sup>49</sup> No other measures were foreseen or permitted under the MFA. In the event of the failure in the consultation process, the requesting party was entitled to impose quotas only at the fixed level as stipulated, which were in fact the least popular safeguard actions under the GATT.<sup>50</sup>

### **1.2.3 Compensation and retaliatory actions**

Under Article XIX GATT, economic losses of the Member subject to safeguard measures are recompensed through one of the following means: the compensation provided by the importing Member and agreed during the pre-action consultation;<sup>51</sup> or the retaliatory action enforced unilaterally by the exporting Member when no agreement is achieved in the first case.<sup>52</sup> A typical example of the former is the offer proposed by the importing Member to further open up its market in other products of export significance to the affected exporters. According to Article XIX:3 GATT, retaliation in the latter situation mainly takes the form of the suspension of substantially equivalent concessions or other obligations under the GATT. A report indicated that Members had been more inclined to compensation rather than retaliation/implementations proposals.<sup>53</sup> In contrast, Article 3 MFA did not provide the chance for unilateral retaliation. This absence rendered the targeted exporting

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<sup>48</sup> In practice, safeguard measures under Article XIX GATT generally take the form of quotas, tariffs and tariff quotas.

<sup>49</sup> Article 3.5 MFA.

<sup>50</sup> For detailed discussion on contemplated safeguard measures, see Chapter III Section 3.2.1.

<sup>51</sup> Article XIX:2 GATT.

<sup>52</sup> Article XIX:3 GATT.

<sup>53</sup> Yong-Shik Lee, n.32, p.153.

countries in a rather unfavourable position: in the case of failure during the consultations, the importing Member could nevertheless adopt the proposed restriction without paying any price for it.

The lack of retaliatory action overtly goes against the underlying rationale of safeguards. In particular, measures of this type have been considered as an exception of emergency, which would otherwise be incompatible with the trading rules under the GATT. First of all, they belong to such trade restrictions, which upset the balance of concessions agreed between the importing and exporting countries. Basically, safeguard measures constitute a breach of the fixed tariff concession as well as of the prohibition of quantitative restrictions under Article XI GATT. More importantly, in contrast to other contingent instruments against dumping and subsidies, these measures apply to the regular, or legitimate, commercial operations not involving illegal trade practices on the part of exporters.<sup>54</sup> As a result, the balance of concessions, which has been distorted by the imposition of the safeguard measure, should be restored sufficiently for the loss of trade. It would not be fair for the exporting countries to hold themselves to their concessions in relation to the importing country which suspends its own concessions to restrict imports. Where compensation for the exporting country is not achieved during the consultations, it is persuasive to allow the affected countries to make up their losses through suspending or withdrawing tariff concessions. It has to be pointed out that despite the negative connotation of the term, retaliation in the context of safeguards is not necessarily punitive in nature, as it just attempts to restore the balance of concessions, which has already been upset by the application of a safeguard measure.<sup>55</sup>

### **1.3 The MFA achievements in sectoral liberalisation**

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<sup>54</sup> Huan Liu and Laixiang Sun, 'Beyond the phase-out of quotas in the textiles and clothing trade: WTO-plus rules and the case of US safeguards against Chinese exports in 2003', *Asia-Pacific Development Journal*, 11(1): 49-71, p. 57. However, there is the political necessity of maintaining provisions of this type within the multilateral trade deal: finding a systemic way of channelling, controlling, and limiting protectionist pressure in order to maintain the necessary domestic political consensus for trade liberalisation has been the holy grail of GATT/WTO safeguards reform for many years. Countries negotiating reciprocal tariff reductions want to reserve the right to invoke safeguard protection in case future import competition raises protectionist pressures at home. As a price for this political gain, the importing countries usually agree to pay for the loss suffered by the targeted supplier countries, or otherwise, accept the retaliations from those countries. Arguably, safeguards can be seen as a fair deal only from this viewpoint.

<sup>55</sup> Yong-Shik Lee, n.32, p.153.

During the MFA era, sectoral liberalisation in textile trade primarily focused on the gradual release of import quotas. However, Article 2 MFA shielded such restrictions from being removed through the application of Articles 3 and 4. In brief, both Articles were based on the domestic demand for trade protection in the case of market disruption, although to different extents. As discussed in the preceding part, Article 3 required the existence of market disruption as the major substantive condition for safeguard action under the MFA. However, according to Article 4, restraints under bilateral textile agreements could be imposed when the real risk of market disruption was proved. In particular, it was provided that “participating countries may, consistently with the basic objectives and principles of this arrangement, conclude bilateral agreements on mutually acceptable terms in order, on the one hand, to eliminate real risks of market disruption in importing countries and disruption to the textile trade of exporting countries, and on the other hand, to ensure the expansion and orderly development of trade in textiles and the equitable treatment of participating countries”.<sup>56</sup> Therefore, provisions under the bilateral agreement concluded mainly concerned the issues between the exporting and the importing countries relating to the management of quantitative restrictions, namely the level of import quotas, growth rates and the adjustment flexibility.<sup>57</sup>

In fact, Article 4 was, at the time of negotiations, considered one of the fundamental provisions of the MFA system. This was mainly because the most influential participants, such as the US and the EC, took the view that the principal aim of the MFA - the ordered development of trade - could be best secured by the conclusion of bilateral agreements with the supplier countries. Taking the EC as an example, the Community agreements negotiated under this Article were essentially based on the Voluntary Export Restraints (VERs) upon the most sensitive textile products committed by the supplier countries; and furthermore, a special safeguard system was also included to deal with contingent import surges.<sup>58</sup>

It is also important to note that no time limit was established under Article 4. Therefore, bilateral agreements and the quantitative restrictions established therein could exist as long as the MFA remained in force. In fact, throughout the MFA governance of 20 years in textiles, the Article 4 agreements between exporting and

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<sup>56</sup> Article 4.2 MFA.

<sup>57</sup> Ibid.

<sup>58</sup> For detailed discussion on the EU textile safeguard mechanism, see Chapter II Section 3.1.

importing parties have been recognised as the principal implementing instrument in sectoral trade management.

Furthermore, as Article 4(3) provided, bilateral agreements should, in overall terms, be more liberal than measures under Article 3. This is a reasonable prerequisite in that measures under Article 3 were subject to the actual existence of market disruption while Article 4 merely required the potential risks of it to take appropriate actions.<sup>59</sup> Therefore, the underlying rationale seems to be that the original, or initial, aim of Article 4 is to encourage the contracting parties to adopt more liberal policies among themselves than those envisaged under the MFA. However, the situation in practice did not evolve in line with this expectation and most Article 4 agreements actually imposed more trade restrictions than the safeguard mechanism under Article 3.

For example, the MFA safeguards were subject to strict application duration with the maximum of two years. Extension and renewal are explicitly restricted unless agreed bilaterally. Annex B further stipulated the threshold levels and the annual growth rate for those restrictions. In contrast, similar provisions, highlighting the conditions on restriction application as well as the interests of countries suffering the restriction, were not required under bilateral textile agreements. Instead, Article 4 merely established a few general requirements. For example, participating countries could “consistently with the basic objectives and principles of this arrangement, conclude bilateral agreements on mutually acceptable terms”.<sup>60</sup> The term “basic objectives and principles” seemed too flexible to result in any substantive curb on the imposition of quantitative restrictions. Therefore, in pursuit of more national discretion as well as higher domestic protection, most participating countries, especially the developed importers, chose to establish their own textile regimes through concluding bilateral agreements rather than being bound by the MFA safeguards. However, the MFA-compatibility of these regimes, which set up more stringent restrictions than Article 3, is highly questionable especially in terms of the requirement for the more liberal policy mentioned above.

Hence, in general, the MFA failed to achieve its objectives for extensive reduction of

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<sup>59</sup> Article 3.2 and Article 4.2 MFA. Niels Blokker, n.9, p. 179.

<sup>60</sup> Article 4.2 MFA.

barriers and a substantial increase in the export earnings of the developing countries. This disappointment was manifestly represented by the prevalence of quantitative restrictions during the period of 1970s - 1990s. Particularly in the US textile industry, it is submitted that, as a result of MFA limitations, the added annual cost to American consumers for each domestic job saved from elimination in the apparel industry was approximately \$82,000 and that the cost per job saved in the same industry was approximately \$135,000. These amounts were, of course, far in excess of the wages earned by typical workers in the industry.<sup>61</sup>

In sum, it was the bilateral agreements between the participants, rather than the multilateral MFA rules, that constituted the primary trading instruments prior to the 1990s. The dependence on the bilateral approach considerably decreased the effectiveness of MFA disciplines: deviations towards sectoral protectionism could be easily achieved through concluding bilateral deals where the exporting countries were located at a markedly vulnerable position.

## ***Section II. The WTO Agreement on Textiles and Clothing***

Under the MFA system, a framework was established for industrial countries to negotiate with exporting countries in the developing world, with a resultant formation of a vast web of bilateral export restraint agreements.<sup>62</sup> The MFA has been criticised, therefore, not for simply allowing quotas, but for actually being based on them.<sup>63</sup>

The MFA, after a series of extensions, remained in force until the WTO Uruguay Round. On January 1, 1995 it was eventually replaced by the ATC representing a significant achievement of the WTO.<sup>64</sup> The ATC set out a sectoral reform project in T&C, the aims of which included the ultimate removal of quantitative restrictions and the final integration into the system under GATT 1994. Hence, from 1995 onwards, international trade in T&C went through fundamental changes under the 10-year transitional programme and WTO Members committed themselves to

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<sup>61</sup> Cline William R, *The Future of World Trade in Textiles and Apparel*, Washington: Institute for International Economics, p.222.

<sup>62</sup> Sara Dillon, *International Trade and Economic Law and the European Union*, Oxford: Hart, 2002 p.229.

<sup>63</sup> Ibid.

<sup>64</sup> For the text of the ATC, see [http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm#textiles](http://www.wto.org/english/docs_e/legal_e/legal_e.htm#textiles).

remove all the quotas by January 1, 2005.

To start with, the MFA and the ATC represent two successive multilateral trading systems in the same sector; thus, the relationship between them needs to be clarified first. This issue is of significant importance when interpreting provisions under the ATC. According to Article 31 VCLT, “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”. The question thus arises as to whether the MFA could be considered as part of the context of the ATC. In this regard, the WTO panel in *US-Cotton Yarn* provided a negative answer, according to which the MFA was not an integral part of the WTO Agreement, and thus was not made in connection with the conclusion of the ATC.<sup>65</sup> Furthermore, it also pointed out that the MFA could still be part of the circumstances of the conclusion of the ATC within the meaning of Article 32 VCLT. In particular, Article 32 VCLT explicitly refers to the preparatory work of the treaty and the circumstances of its conclusion as the supplementary means of interpretation.

In treaty interpretation, there is an inherent reference hierarchy between Articles 31 and 32 VCLT: recourse shall be made to Article 32 only to confirm the meaning resulting from the application of Article 31, or to determine the meaning when Article 31 leaves it ambiguous or obscure or leads to a result which is manifestly absurd or unreasonable. Insofar as it is sufficient to interpret particular provisions following the rules under Article 31, the use of Article 32 would be unnecessary and thus cannot be justified. Consequently, for the purpose of interpreting the ATC, the MFA is excluded from reference in most cases.

Under the ATC, two targets were established in the Preamble, namely the integration of the T&C trade into the WTO system and further market liberalisation in this sector.<sup>66</sup> The ATC, in general, is a reform instrument built on the following key elements: (a) the product coverage, generally encompassing yarns, fabrics, made-up textile products and clothing; (b) a programme for the progressive integration of these textile and clothing products into GATT 1994 rules; (c) a liberalisation process to progressively enlarge existing quotas, until they are removed, by increasing

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<sup>65</sup> *US-Cotton Yarn*, Panel Report, WT/DS192/R, para. 7.74.

<sup>66</sup> Preamble ATC.

annual growth rates at each stage; (d) a special safeguard mechanism to deal with new cases of serious damage or threat thereof to domestic producers during the transitional period; (e) establishment of a Textiles Monitoring Body (TMB) to supervise the implementation of the Agreement and ensure that the rules are faithfully followed; and (f) other provisions, including rules on circumvention of the quotas, their administration, treatment of non-MFA restrictions, and commitments undertaken elsewhere under the WTO agreements and procedures affecting this sector.<sup>67</sup>

Furthermore, Article 9 provided that “this Agreement and all restrictions thereunder shall stand terminated on the first day of the 121st month that the WTO Agreement is in effect, on which date the T&C sector shall be fully integrated into GATT 1994. There shall be no extension of this Agreement”. Two conclusions can be drawn from this Article. First, the ATC was transitional in nature and the duration of ten years was fixed. Second, from January 1, 2005, international trade in T&C, as with other industrial sectors, would be exclusively governed by the rules of GATT 1994.

Before looking into the substance of the ATC, the following section will first explore the relationship between the ATC and GATT 1994. Examination of this issue not only closely links to the applicability of WTO rules in the T&C sector, it also provides resolution for the norm conflicts between those rules. Following on from this, discussion will move onto the major ATC instruments, including the integration programme, the acceleration mechanism, the transitional safeguards and the dispute settlement procedures.

## **2.1 The relationship between GATT 1994 and the Annex 1A Agreements**

Apart from GATT 1994, Annex 1A contains a series of multilateral agreements governing trade in goods with different economic focuses.<sup>68</sup> The ATC belonged to one of them.

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<sup>67</sup> Information from [http://www.wto.org/english/tratop\\_e/texti\\_e/texintro\\_e.htm](http://www.wto.org/english/tratop_e/texti_e/texintro_e.htm).

<sup>68</sup> The Annex 1A Agreements cover a wide range of disciplines, including agriculture, sanitary and phytosanitary measures, textiles and clothing, technical barriers, trade-related investment measures, anti-dumping and countervailing measures, pre-shipment inspection, rules of origin, import licensing procedures and safeguards.

Because of the wide coverage of the WTO, full consistency among all the trading rules is hardly guaranteed, and overlapping or even conflict is unavoidable. The WTO negotiators as well as the treaty drafters clearly realised this problem and, as a result, inserted the so-called “conflict clauses” into the final text.<sup>69</sup> For example, Article XVI:3 of the WTO Agreement provides that “in the event of a conflict between a provision of this Agreement and a provision of any of the Multilateral Trade Agreements, the provision of this Agreement shall prevail to the extent of the conflict”. Furthermore, according to the General Interpretative Note to Annex 1A, in the event of conflict between a provision of GATT 1994 and a provision of another agreement in Annex 1A, the latter shall prevail. It is submitted that much can be done to avoid conflict by a sustained effort to secure the inclusion of appropriate provisions in instruments when they are drafted.<sup>70</sup> Without doubt, the General Interpretative Note shall be the major conflict clause in dealing with the GATT-ATC conflicts. However, this provision cannot be expected to resolve all the problems that emerge; and in this regard, the WTO jurisprudence provides further elaborations on the following issues.

First, in several cases,<sup>71</sup> the panels and the Appellate Body have consistently insisted on cumulative application of the trading rules included in different WTO agreements. This means, as a general rule, that WTO obligations are cumulative and Members must comply with all of them at all times unless there is a formal “conflict” between them.<sup>72</sup> Therefore, in the T&C sector, provisions of both the ATC and GATT 1994 shall apply together in most cases; when conflict arises, however, the ATC rules would prevail and replace the conflicting rules from the GATT in accordance with the General Interpretative Note,.

Second, the WTO judicature also shed light on the definition and meaning of the term “conflict”. This term is of significant importance since it suggests the only occasion that two WTO rules are considered exclusive to each other and one of them must be abandoned. Under the WTO, panels and the Appellate Body have sought to uphold

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<sup>69</sup> Joost Pauwelyn, n.13, p. 437.

<sup>70</sup> C. Wilfred Jenks, ‘The conflict of law-making treaties’, *British Year Book of International Law*, (1953) 30, 401-453.

<sup>71</sup> *EC-Bananas*, Panel Report, WT/DS27/R/ECU, para. 7.160; *Gutemala-Cement*, Appellate Body Report, WT/DS60/AB/R, para. 65; *Korea-Dairy*, Appellate Body Report, WT/DS98/AB/R, para. 76-77; *Argentina-Footwear*, Appellate Body Report, WT/DS121/AB/R, para. 83-89.

<sup>72</sup> *Turkey—Textiles*, Appellate Body Report, WT/DS34/AB/R, para. 9.92.

the unity of the WTO system by applying the conflict norms in exceptional circumstances only.<sup>73</sup> Consequently, an overall narrow definition of “conflict” has prevailed in the jurisprudence. In *EC-Bananas*, the panel was of the view that the General Interpretative Note is designed to deal with (i) clashes between obligations contained in GATT 1994 and obligations contained in agreements listed in Annex 1A, where those obligations are mutually exclusive in the sense that a Member cannot comply with both obligations at the same time, and (ii) the situation where a rule in one agreement prohibits what a rule in another agreement explicitly permits.<sup>74</sup> A similar definition was provided later in *Guatemala-Cement* in the context of the DSU. In that case, the Appellate Body defined the term of conflict in Article 1.2 of the DSU as a situation where adherence to the one provision will lead to a violation of the other provision, that is, in the case of a conflict between them.<sup>75</sup>

In *EC-Bananas*, particular reference was made to the T&C sector.<sup>76</sup> On the one hand, Article XI:1 of GATT 1994 set forth a general prohibition on the imposition of these quantitative restrictions. On the other hand, Article 2.1 ATC explicitly allowed for the maintenance of the MFA quantitative restrictions subject to certain conditions. In other words, Article XI:1 prohibits what Article 2.1 permitted in equally explicit terms, which, according to the ruling in *EC-Bananas*, represents the second form of the conflict. Adherence to the latter will, without doubt, lead to a violation of the former. Therefore, this situation was recognised as a conflict of norms and an obligation or authorisation embodied in the ATC prevailed over the conflicting obligation provided for by GATT 1994.<sup>77</sup>

This narrow view on the definition of conflict has been generally followed in public international law. As the International Law Commission, in the study on fragmentation of international law, defined it, normative conflict refers to the case where two norms that are both valid and applicable point to incompatible decisions

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<sup>73</sup> Elisabetta Montaguti and Maurits Lugard, ‘The GATT 1994 and other Annex 1A agreements: four different relationships?’, *Journal of International Economic Law*, (2000) 3, 473-484, p.484.

<sup>74</sup> *EC-Bananas*, Panel Report, n. 57, para. 7.159.

<sup>75</sup> *Guatemala-Cement*, Appellate Body Report, n. 57, para.65. It has been argued that the Appellate Body established a stricter and narrower definition of the term conflict in *Guatemala-Cement* than the one in *EC-Bananas*, by excluding the situation where a rule in one agreement prohibits what a rule in another agreement explicitly permits. However, no apparent divergence in effect exists between the definitions in these two disputes, at least in terms of the literal interpretation.

<sup>76</sup> *EC-Bananas*, Panel Report, n. 57, Footnote 401.

<sup>77</sup> *Ibid.*

so that a choice must be made between them.<sup>78</sup> This is the logical result arising from the recognition of international law as a legal system and the principle of harmonisation.<sup>79</sup> The rules and principles of international law act in relation to, and should be interpreted against, the background of other rules and principles; meanwhile, it is a generally accepted principle that when several norms bear on a single issue they should, to the extent possible, be interpreted so as to give rise to a single set of compatible obligations.<sup>80</sup>

It is also argued that the presumption against an interpretation which involves a conflict between law-making treaties is simply a detailed application of such fundamental principles of treaty interpretation as the principle of reasonableness, the principle of good faith, and the presumption of consistency with international law.<sup>81</sup> In this sense, the scope of the conflict shall be reduced to the minimum extent simply because the application of the so-called conflict clause would render one of the conflicting provisions meaningless. In the WTO context, the Appellate Body observed that one of the corollaries of the “general rule of interpretation” in the VCLT is that interpretation must give meaning and effect to all the terms of a treaty. As a result, an interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.<sup>82</sup>

Apart from the foregoing case of normative conflicts, there are also other circumstances where rules from an Annex 1A Agreement would prevail over the GATT provisions. Rather than the application of the conflict clause, this prevalence derives from the “express derogation” or the “cross reference” explicated in the Agreement concerned.<sup>83</sup> In general, both exceptions point to a situation where particular provision under the Annex 1A Agreement permits WTO Members to act inconsistently with another GATT 1994 obligation.<sup>84</sup> An example in this regard has been demonstrated in *EC-Bananas*. In that case, Article 5 of the Agreement on Agriculture allows Members to impose special safeguard measures that would

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<sup>78</sup> ‘Conclusions of the work of the Study Group on the fragmentation of international law: difficulties arising from the diversification and expansion of international law’, n.16, p.2.

<sup>79</sup> See Official Records of the General Assembly, Fifty-eighth Session, International Law Commission (A/61/10), available at <http://untreaty.un.org/ilc/reports/2006/2006report.htm>, paras. 233-251.

<sup>80</sup> Ibid.

<sup>81</sup> C. Wilfred Jenks, n.56.

<sup>82</sup> *US-Gasoline*, Appellate Body Report, WT/DS2/AB/R, Part IV.

<sup>83</sup> Elisabetta Montaguti and Maurits Lugard, n.59, p.477.

<sup>84</sup> Ibid.

otherwise be inconsistent with Article XIX of the GATT 1994 and the SGA. According to the Appellate Body, “if the negotiators had intended to permit Members to act inconsistently with Article XIII of GATT 1994, they would have said so explicitly...as we have noted, the negotiators of the Agreement on Agriculture did not hesitate to specify such limitations elsewhere in that agreement; had they intended to do so with respect to Article XIII of the GATT 1994, they could, and presumably would, have done so”.<sup>85</sup> Derogations of this type also appeared in the ATC. In particular, Footnote 3 of the ATC explicitly excluded the application of Article XIX GATT in respect of products not yet integrated into GATT 1994. Furthermore, Article 1.6 ATC also stipulated that “unless otherwise provided in this Agreement, its provision shall not affect the rights and obligations of Members under the provisions of the WTO Agreement and the Multilateral Trade Agreements”.

In sum, in the sector of T&C, provisions of GATT 1994 and the ATC shall apply cumulatively except in two circumstances. The first occurs where a conflict of norms, as defined in *EC-Bananas* and *Guatemala-Cement*, between the GATT and the ATC emerges. The second occurs where the express derogation from the latter is explicitly authorised in the text of the former. Under both situations, the ATC provisions concerned would prevail over their counterparts under the GATT, as a result of either the General Interpretative Note, or the “express derogations” included therein. Nevertheless, it has to be pointed out that, in most cases, trading rules contained in both agreements shall be operated in combination governing the international T&C trade.

## **2.2 The integration programme**

The principal task of the ATC is to integrate the T&C sector into GATT 1994 and a specific programme was thus established in Article 2, which stipulated in detail how WTO Members should carry out the integration process over the 10-year period.

According to Article 2, the integration process was divided into three stages. The first stage started on January 1, 1995 with the products to be integrated representing not less than 16 per cent of the Member's total 1990 imports of

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<sup>85</sup> *EC-Bananas*, Appellate Body Report, WT/DS27/AB/R, para. 157.

T&C. At stage two, beginning on January 1, 1998, not less than a further 17 per cent shall be completed. Stage three from the beginning of 2002 should cover at least another 18 per cent of the total quantity. Eventually, at the end of 2004, all remaining products, amounting up to 49 per cent of 1990 imports into the Member, would be brought within the remit of the GATT leading to the termination of the ATC. To reach these thresholds, each importing WTO Member could decide by itself which products it would integrate at each stage. The only constraint was that the integration list must have encompassed products from each of the four groupings: tops and yarns, fabrics, made-up textile products, and clothing.<sup>86</sup>

Canada, the EU, Norway and the US, which carried the MFA restrictions into the ATC, were required to undertake this integration process and to notify the first phase of their programmes by October 1, 1994. The other WTO Members had, first, to declare whether they wished to retain the right to use the transitional safeguard mechanism in Article 6 and, if so, provide their first stage integration lists.<sup>87</sup> Fifty-five Members chose to retain this right and most of them provided their lists required. In contrast, nine Members, namely, Australia, Brunei Darussalam, Chile, Cuba, Hong Kong, Iceland, Macau, New Zealand and Singapore, decided not to. In other words, T&C trade in these Members would be exclusively governed by the GATT system from the outset.

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### **2.2.1 What happens after the integration?**

The following analysis will focus on the legal effect and the outcome of the integration programme. Owing to the principle of cumulative application analysed earlier, before the integration took place, trades of the T&C products were subject to

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<sup>86</sup> Article 2.6 ATC.

<sup>87</sup> Article 2.9 provided that “Members which have notified, pursuant to paragraph 1 of Article 6, their intention not to retain the right to use the provisions of Article 6 shall, for the purposes of this Agreement, be deemed to have integrated their textiles and clothing products into GATT 1994”. The link between the utilisation of the transitional safeguards and the integration mechanism then becomes clear: if the ATC Member declared that it would retain the right to use the safeguard measures under Article 6 ATC, this declaration signified that this Member is still under the process of integration and different trading rules would simultaneously apply to its textile sector depending on the particular products concerned; otherwise, if the ATC Member explicitly renounced this right, the entire textile sector of this Member would be governed by the GATT rules only.

<sup>88</sup> Information from [http://www.wto.org/english/tratop\\_e/texti\\_e/texintro\\_e.htm](http://www.wto.org/english/tratop_e/texti_e/texintro_e.htm).

the combined governance from the GATT and the ATC. Once the product concerned was integrated into the former, it would, from then on, be regulated solely by the GATT rules and the application of the T&C-specific rules under the ATC would be excluded. For example, the transitional safeguard measures under Article 6 ATC would be substituted by Article XIX GATT and the SGA; and quantitative restrictions authorised under Article 2 ATC would not be permitted any more owing to the flat prohibition under Article XI:1 GATT.

Therefore, according to the progress of the integration programme, T&C products would split into two groups and under each group products were subject to different trading rules. While the un-integrated group were following the rules from both the GATT and the ATC, the integrated products were traded and regulated in the same way as products from other industries and recourse to the ATC was no longer permitted. During the progress of the integration programme, the dividing line between these two groups had been moving towards the outcome that more and more T&C products entered into the exclusive supervision of the GATT disciplines.

### **2.2.2 Domestic enforcement of the integration programme**

Although all WTO Members had fulfilled their commitments under Article 2, the progress and the achievement of the integration programme were considerably deflated. There are two major reasons. First of all, the percentages required under Article 2 referred to the total volume of trade in 1990, rather than the commercial value thereof. Consequently, the products integrated were most likely to account for less in value terms than expressed in volume, on which the integration schedule was based. Second, most quota-imposing countries, i.e. the US and the EU, chose to first integrate those products that were not under quota, or had highly underutilised quotas, or were low-unit-value items.<sup>89</sup> They deferred integration of the most sensitive articles, such as higher value-added items, until the end of the transitional period. Thus, little liberalisation of items with substantial trade potential actually took place during the first two stages. As a result, an adjustment shock in both exporting and importing countries, which indeed emerged in 2005 shortly after the expiry of the ATC, could be easily predicted and seemed unavoidable.<sup>90</sup>

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<sup>89</sup> The Textiles Monitoring Body observed that there was a tendency to integrate products where quota utilisation was particularly low. In the case of Canada, out a total of 27 specific constraints to be eliminated, 19 had a utilisation rate of less than 50 per cent in the year 2000, and of these six had zero utilisation rates. The corresponding figures for the EU were that out of 37 specific constraints to be eliminated, 28 had a utilisation rate of below 50 per cent, while in the United States, out of 43 specific constraints to be eliminated, 21 had utilisation rates below 50 per cent and of these the utilisation rate was zero for three quotas. Hildegunn Kyvik Nordås, 'The global textile and clothing industry post the Agreement on Textiles and Clothing', Discussion Paper No.5, World Trade Organization, Geneva, Switzerland, p.14.

<sup>90</sup> Jorg Mayer, 'Not totally naked: textiles and clothing trade in a quota-free environment', *Journal of World Trade*, (2005) 39, 393-426, p.398.

### **2.3 The acceleration mechanism**

In pursuit of the aim of gradually enlarging the existing quotas, the ATC established an acceleration mechanism. Together with the integration programme, they constituted the principal instruments to achieve liberalised trade in the T&C sector.

As mentioned earlier, the ATC provided exceptions to the general prohibitions contained in Articles XI and XIII GATT against discriminatory quantitative restrictions and allowed the Members to maintain such restrictions for a maximum period of 10 years. Generally speaking, two groups of restrictions existed in the T&C sector. First of all, they could be based on the MFA rules, either as bilaterally accepted measures under Articles 4, 7 or 8, or as unilateral safeguard measures under Article 3. Second, there were also a number of non-MFA quantitative restrictions between the trading partners. One example is the quotas imposed by the EU upon T&C import from the so-called state-trading countries.<sup>91</sup>

According to the acceleration mechanism, the mutually accepted MFA restraints in the first group could, on the one hand, be carried over into the ATC subject to certain conditions.<sup>92</sup> On the other hand, however, they should be eliminated either when the products concerned were integrated into the GATT at any of the stages or at the end of the 10-year transition period.<sup>93</sup> Furthermore, all the MFA safeguard measures could also be maintained, but had to be removed within one-year's time under the revision by the competent institutions.<sup>94</sup> For non-MFA quantitative restrictions in the second group, relevant information should be provided to the designated bodies of the ATC and the WTO;<sup>95</sup> moreover, in accordance with their reform schedules submitted in 1995, importing Members concerned were required either to bring those quotas into conformity with GATT rules, or to phase them out within the ten-year time frame.<sup>96</sup>

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<sup>91</sup> Council Regulation 517/94 on common rules for imports of textile products from certain third countries not covered by bilateral agreements, protocols or other arrangements, or by other specific Community import rules, OJ, L 067, 10/03/1994, p. 1-75.

<sup>92</sup> Article 2.1 ATC.

<sup>93</sup> Article 2.15 ATC.

<sup>94</sup> Article 2.5 ATC.

<sup>95</sup> Article 3.2 ATC.

<sup>96</sup> Article 3 ATC.

In sum, for most existing quantitative restrictions, the acceleration mechanism first established the preconditions for the importing Members concerned, the fulfilment of which was compulsorily required for extended maintenance under the ATC. Furthermore, under this mechanism, those Members also had to submit a specified schedule on the quota release at each stage. In any event, all the restrictions shall be removed at the end of 2004.

### **2.3.1 Obligation of notification**

This obligation was elaborated in Article 2.1 ATC, which required that “all quantitative restrictions within bilateral agreements maintained under Article 4 or notified under Article 7 or 8 of the MFA in force on the day before the entry into force of the WTO Agreement shall, within 60 days following such entry into force, be notified in detail, including the restraint levels, growth rates and flexibility provisions, by the Members maintaining such restrictions to the Textiles Monitoring Body provided for in Article 8”. According to the WTO panel in *Turkey-Textiles*, the lists of restrictions notified pursuant to Article 2.1 set the starting point for the treatment of the restraints carried over from the former MFA regime.<sup>97</sup> Furthermore, the panel was also of the view that the notification requirement of 60 days was mandatory both for formal and substantive reasons.<sup>98</sup> Therefore, only the Members which had fulfilled this notification obligation were allowed to maintain their MFA-derived quantitative restrictions, which were nevertheless subject to annual increase until being integrated into the GATT.

### **2.3.2 The definition of “new restrictions”**

For the integration of the T&C sector, not only should the existing quotas mentioned above be gradually lifted, it is equally important to prevent new restrictions from being imposed. Relevant provisions in this regard were stipulated in Article 2.4 ATC, according to which, the restrictions included in the notification list shall be deemed to constitute the totality of such restrictions applied by the respective Members on the day before the entry into force of the WTO Agreement. No new restrictions in terms of products or Members shall be introduced except under the provisions of this

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<sup>97</sup> *Turkey - Textiles*, Panel Report, WT/DS34/R, para 9.69.

<sup>98</sup> *Ibid.*

Agreement or relevant GATT 1994 provisions; and restrictions not notified within 60 days of the date of entry into force of the WTO Agreement shall be terminated forthwith.<sup>99</sup>

Dispute indeed arose regarding the nature of the restriction, which had been originally notified to the ATC but was subsequently increased by the importing Member. In particular, it concerned the question whether the increased restriction could be exempted from Article 2.1 or should be treated as a new restriction subject to Article 2.4. According to the panel in *Turkey – Textiles*, the ordinary meaning of Article 2.4 indicated that WTO Members intended that, as of 1 January 1995, the incidence of restrictions under the ATC could only be reduced. Therefore, any legal fiction whereby an existing restriction could simply be increased and not constitute a "new restriction" would defeat the clear purpose of the ATC which was to reduce the scope of such restrictions.<sup>100</sup> In other words, setting aside the possibility of exceptions and justifications mentioned in Article 2.4, any increase of an ATC-compatible quantitative restriction notified earlier under Article 2.1, would constitute a "new" restriction, which was strictly limited under Article 2.4.<sup>101</sup>

### **2.3.3 Domestic enforcement of the acceleration mechanism**

In the course of implementation, the acceleration mechanism was considerably compromised. Although all the quota-imposing Members complied in full with their commitments and promised that quotas would end on January 1, 2005, it was alleged that they had pursued a deliberate policy of back-loading the process, maintaining the bulk of restrictions untouched throughout the ten-year period. In practice, the list of products that had to have their quotas removed was inflated by a large number of items on which there had never been quotas before. Meanwhile, almost all the sensitive items, i.e. those that would face the greatest competitive pressures from developing country exports and would therefore be of most benefit to developing countries, were left to the final tranche.<sup>102</sup> During the first two stages, the Members indeed fulfilled their commitments under the acceleration mechanism by selecting

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<sup>99</sup> Article 2.4 ATC.

<sup>100</sup> *Turkey - Textiles*, Panel Report, n. 83, para 9.71.

<sup>101</sup> *Ibid.*

<sup>102</sup> James Scott, 'The use and misuse of trade negotiation simulations', *Journal of World Trade*, (2008) 42, 87-103, p.90.

products from the T&C categories of minimal interest to developing exporters.<sup>103</sup>

As a result, only 103 out of a total 937 quotas notified by the US, 91 out of 303 maintained by the EU, and 76 out of 368 in the case of Canada had been phased out before the final ATC stage.<sup>104</sup> In other words, until the beginning of 2005, 89 per cent of the US quotas, 70 per cent of the EU and 79 per cent of the Canadian were maintained in place. According to one Communication of the EU, concentrating only on imports in restricted categories with a quota utilisation above 80 per cent, the study considered that the Uruguay Round liberalisation was relevant only for 13 per cent of the EU's T&C imports.<sup>105</sup>

#### **2.4 The transitional safeguards**

Another key instrument under the ATC was Article 6 on transitional safeguards aimed at protecting WTO Members against damaging surges in T&C imports. As the panel in *US-Underwear* indicated, the overall purpose of this Article was to give Members the possibility of adopting new restrictions on products not already integrated into the GATT pursuant to Article 2.6 to 2.8 and not under existing restrictions, i.e. not notified under Article 2.1.<sup>106</sup>

In fact, the Article 6 mechanism differed from both the traditional textile-specific safeguards, i.e. those under Article 3 MFA and bilateral textile agreements, and the general WTO system under Article XIX GATT and the SGA, and was better viewed as a transitional device between them. Under Article 6, the transitional safeguard may be taken when it is demonstrated that a particular product is being imported into its territory in such increased quantities as to cause serious damage, or actual threat thereof to the domestic industry producing like and/or directly competitive products. Any measure invoked pursuant to the provisions of this Article shall be applied on a Member-by-Member basis. The Member proposing to take safeguard action shall seek consultations with the Member or Members which would be affected by such

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<sup>103</sup> Ibid.

<sup>104</sup> 2004 major review of the implementation of the Agreement on Textiles and Clothing, available at [http://www.wto.org/english/tratop\\_e/texti\\_e/texti\\_e.htm](http://www.wto.org/english/tratop_e/texti_e/texti_e.htm), paras, 16 – 17.

<sup>105</sup> Commission Communication Paper, 'The impact of Uruguay Round on the Community's textiles and clothing sector', 06.10.1995.

<sup>106</sup> *US-Underwear*, Panel Report, WT/DS24/R, para.7.23.

action and the request for consultations shall be accompanied by specific and relevant factual information.

If, in the consultation, there is mutual understanding that the situation calls for restraint on exports, the level of such restraint shall be fixed at a level not lower than the actual level of exports or imports from the Member concerned during the 12-month period terminating two months preceding the month in which the request for consultation was made. If, however, there has been no agreement between the Members within 60 days, the Member which proposed to take safeguard action may apply the restraint within 30 days following the 60-day period for consultations.

It thus becomes clear that Article 6, on the one hand, maintained the selective, or regional, application of the safeguards prevailing in the previous sectoral mechanisms under the MFA. Meanwhile, there was nevertheless an evident move in substantive requirement towards the general WTO safeguards. In particular, it removed the term of “market disruption” and instead, specified the threshold of “serious damage”.

In the WTO jurisprudence, the ATC safeguards were generally characterised, first and foremost, as a fundamental part of the rights and obligations of WTO Members during the transitional period.<sup>107</sup> In the meanwhile, their exceptional nature was nevertheless highlighted. As the panel in *US-Underwear* pointed out, “based upon the wording, the context and the overall purpose of the Agreement, exporting Members can legitimately expect that transitional safeguards, adopted under Article 6 of the ATC, would be applied only sparingly in order to serve the narrow purpose of protecting domestic producers of like and/or directly competitive products”.<sup>108</sup> Therefore, recourse to this mechanism should be taken on an exceptional basis only and a strict, or narrow, approach should be followed during the course of interpretation.<sup>109</sup>

With regard to the scope of application, the transitional safeguards were not universally applicable to all T&C products. According to Article 6.1, “the transitional safeguard may be applied by any Member to products covered by the Annex, except

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<sup>107</sup> *US – Shirts and Blouses*, Appellate Body Report, WT/DS33/AB/R, para. 19.

<sup>108</sup> *US-Underwear*, Panel Report, n. 92, para. 7.20.

<sup>109</sup> *Ibid*, para. 7.21.

those integrated into GATT 1994 under the provisions of Article 2”. Consequently, the application scope of Article 6 was closely linked to the progress of the integration process. In particular, Article 6 merely covered the products to be integrated; and others, which had been incorporated into the GATT, would be regulated under the general WTO safeguards. Furthermore, double imposition of restrictions was not allowed. As Article 6.4 stipulated, “such safeguard measure shall not be applied to the exports of any Member whose exports of the particular product are already under restraint under this Agreement”. Therefore, measures under Article 6 could apply only to the products which had not yet been integrated and were not yet subject to any import quotas.

Generally speaking, three steps are required to trigger an ATC safeguard action. As the Appellate Body explained in the *US - Cotton Yarn* case, three different but interrelated elements in Article 6 shall be distinguished from each other, namely “causation”, “attribution” and “application”.<sup>110</sup> These elements respectively refer to, first, causation of serious damage or actual threat thereof by increased imports; second, attribution of that serious damage to the Member(s) the imports from whom contributed to that damage; and third, application of transitional safeguard measures to such Member(s).<sup>111</sup> According to the panel in the same case, Articles 6.2 and 6.4 constituted the first two steps which, taken together, amounted to a determination that serious damage indeed occurred or was actually threatening to occur and that it might be attributed to a sharp and substantial increase in imports from a particular Member or Members;<sup>112</sup> and “application” – the final element – would start with the bilateral consultations under Article 6.7. Therefore, only when serious damage or an actual threat thereof could be demonstrated under Article 6.2 and be attributed to a particular Member or Members under Article 6.4, could recourse to Article 6.7 be made in a way consistent with the provisions of the ATC.<sup>113</sup>

#### **2.4.1 Serious damage caused by increased T&C imports**

As mentioned above, Article 6.2 ATC set forth the same substantive threshold for action as the WTO safeguards, namely serious damage, or actual threat thereof, to

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<sup>110</sup> *US-Cotton Yarn*, Appellate Body Report, WT/DS192/AB/R, para.109.

<sup>111</sup> *Ibid.*

<sup>112</sup> *US-Underwear*, Panel Report, n. 92, para 7.23.

<sup>113</sup> *Ibid.*, paras. 7.24.

the domestic industry. However, it was further required under that Article that the damage or the actual threat must demonstrably be caused by such increased quantities in total imports of that product and not by such other factors as technological changes or changes in consumer preference.<sup>114</sup> According to the panel in *US-Shirts and Blouses*, with respect to the term “demonstrably”, there was at least an explicit obligation for the investigating authorities to address the question whether serious damage or actual threat thereof to the particular domestic industry was caused the “other factors” mentioned.<sup>115</sup>

In this regard, the Appellate Body in *US- Cotton Yarn* further specified three analytical steps under Article 6.2: (i) an assessment of whether the domestic industry is suffering serious damage or actual threat thereof; (ii) an examination of whether there is a surge in imports as envisaged; and, (iii) an establishment of a causal link between the surge in imports and the serious damage or actual threat thereof.<sup>116</sup> Among others, the primary assessment function of the Article lies in the determination of “serious damage, or actual threat thereof”. Article 6.3 ATC further elaborated this issue, which provided that “the Member shall examine the effect of those imports on the state of the particular industry, as reflected in changes in such relevant economic variables as output, productivity, utilisation of capacity, inventories, market share, exports, wages, employment, domestic prices, profits and investment; none of which, either alone or combined with other factors, can necessarily give decisive guidance”.<sup>117</sup> Upon this point, the panel in *US-Shirts and Blouses* was of the view that “the wording of Article 6.3 makes clear that each of the listed factors is not only relevant but must be examined by the investigation authorities”.<sup>118</sup> In the meantime, the panel did not deny that, in the course of assessment, the importing Member may decide that some of the factors carry more, or less, weight than others; and neither was it required that all these factors have to indicate serious damage or the threat thereof. Instead, the importing Member had to demonstrate that it had considered the relevance of each of the factors listed in that Article.<sup>119</sup>

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<sup>114</sup> Article 6.2 ATC.

<sup>115</sup> *US-Shirts and Blouses*, Panel Report, WT/DS33/R, para.7.50.

<sup>116</sup> *US- Cotton Yarn*, Appellate Body Report, n. 96, para. 112.

<sup>117</sup> Article 6.3 ATC.

<sup>118</sup> *US-Shirts and Blouses*, Panel Report, n. 101, para. 7.25.

<sup>119</sup> *Ibid*, para. 7.26.

#### 2.4.2 Attribution of damage to certain exporting Member(s)

One common feature shared among the T&C-specific safeguards, namely Article 3 MFA, Article 6 ATC and Para 242 of the Working Party Report of China's WTO accession,<sup>120</sup> is that restrictions thereunder are all enforced on a selective basis and the MFN principle, one of the fundamental requirements under the WTO regime, does not apply.

According to Article 6.4 ATC, the Member or Members, to whom serious damage or actual threat thereof is attributed, shall be determined on the basis of a sharp and substantial increase in imports from such a Member or Members individually, and on the basis of the level of imports as compared with imports from other sources, market share, and import and domestic prices at a comparable stage of commercial transaction.<sup>121</sup> However, this does not permit a reading to the effect that only one or some of such Members to whom causation of serious damage is attributed may be subject to restraints. The importing Member cannot pick and choose for which Member it will impose restraints; instead, a comprehensive attribution analysis has to be completed before the decision is made.

As the Appellate Body indicated, the attribution analysis must conform to the two requirements stipulated in Article 6.4. The first one is that the attribution has to be confined only to those Members from whom imports have shown a sharp and substantial increase.<sup>122</sup> Before the appeal, the panel in the same case had interpreted the term 'sharp' to refer to the rate of the import increase, and the term 'substantial' to the amount of that increase.

The second requirement concerns a comparative analysis, in the event that there is more than one Member from whom imports have shown such an increase.<sup>123</sup> Article 6.4 specified several factors to be assessed in this regard, none of which, however, can on its own lead to the decisive guidance. The necessity of such an analysis was clarified by the Appellate Body, which considered that "the clear inference from the text of Article 6.4 is that the sharp and substantial increase of imports from such a

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<sup>120</sup> It refers to the T&C-specific safeguard under Para 242 of the Working Party Report, which will be analysed in detailed in Chapter III.

<sup>121</sup> Article 6.4 ATC.

<sup>122</sup> *US-Cotton Yarn*, Panel Report, n. 51, para. 114.

<sup>123</sup> *US- Cotton Yarn*, Appellate Body Report, n. 96, paras. 114-116.

Member determines not only the basis, but also the scope of attribution of serious damage to that Member. As a result, where imports from more than one Member increase sharply and substantially, the damages for each exporting countries have to be decided on a proportionate and attributed basis; and a ‘mis-attribution’ of damage would be inconsistent with the good faith required during the interpretation of Article 6.4”<sup>124</sup>.

In support of its conclusion, the Appellate Body made reference to the rules of general international law on State responsibility and [Article 22.4 of the DSU on suspension of concessions](#). In particular, it ruled “these two examples illustrate the consequences of breaches by states of their international obligations, whereas a safeguard action is merely a remedy to WTO-consistent ‘fair trade’ activity...it would be absurd if the breach of an international obligation were sanctioned by proportionate countermeasures, while, in the absence of such breach, a WTO Member would be subject to a disproportionate and, hence, ‘punitive’, attribution of serious damage not wholly caused by its exports.”<sup>125</sup>

With regard to the question of how to conduct the comparative analysis, the Appellate Body opined that this analysis is to be seen in the light of the principle of proportionality as the means of determining the scope or assessing the part of the total serious damage that can be attributed to an exporting Member. The comparison is to take place between the effects of imports from the Member in question, on the one hand, and those of imports from other sources, on the other. Therefore, it must be based on a variety of factors, each of which has a different significance and weight, and is to be measured on a different scale.<sup>126</sup> An assessment of the share of total serious damage, which is proportionate to the damage actually caused, requires, therefore, a comparison according to the factors envisaged in Article 6.4 with all other Members, from whom imports have also increased sharply and substantially, taken individually.<sup>127</sup>

#### **2.4.3 Bilateral consultations and the application of safeguard measures**

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<sup>124</sup> *US- Cotton Yarn*, Appellate Body Report Report, n. 96, paras. 119-120.

<sup>125</sup> *Ibid.*

<sup>126</sup> *Ibid.*, para. 123.

<sup>127</sup> *Ibid.*, para. 125.

Following the preliminary investigation discussed above, the application of a ATC safeguard measure started with the bilateral consultations between the importing Member to impose the restraint and the exporting Member, to whom the damage was attributed. According to Article 6.7, the request for consultation should be accompanied by specific, relevant and up-to-date information on the factors, which led the importing Member to make a determination of “serious damage” and the factors which led to the unilateral attribution of such damage to an identified exporting Member. Furthermore, the Member invoking the action shall also indicate the specific level at which imports of the product in question were proposed to be restrained. Normally, the consultations should be completed within 60 days of the date on which the request was received.<sup>128</sup>

The objective of this 60-day consultation period is to give the targeted exporting Member or Members a real and fair, not merely *pro forma*, opportunity to rebut or moderate those factors alleged by the importing Member.<sup>129</sup> The requirement of consultation is thus grounded on, among other things, due process considerations.<sup>130</sup> Furthermore, according to the Appellate Body, it is also clear from the text of this Article that the restraint is to be applied in the future, after the consultation, should these prove fruitless and the proposed measure not withdrawn.<sup>131</sup> In other words, no unilateral action by the importing Member was allowed before the elapse of the 60-day period.

Once the decision for action is made, the ATC raised another two issues during the enforcement process. The first one concerned the retroactive application dating back to the date of the consultation request; and the second one referred to the favourable treatment provided under Article 6.6.

First of all, the reason why retroactive application attracted attention from both importing and exporting Members is that this practice was explicitly permitted under the MFA system. Article 3.5(i) MFA provided for the possibility of backdating preliminary safeguard measures to the date of the importing Member’s call for consultations. Thus, the question arose as to whether this textile-specific practice could be carried over into the ATC. According to Article 6.10, after the expiry of the 60-day period for consultation, the importing Member may apply the restraint by the date of import or export within 30 days following the 60-day period for consultations. Therefore, the

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<sup>128</sup> Article 6.7 ATC.

<sup>129</sup> *US-Underwear*; Appellate Body Report, WT/DS24/AB/R, paras. 14-15.

<sup>130</sup> *Ibid.*

<sup>131</sup> *Ibid.*

prevalent practice under the MFA of setting the initial date of a restraint period as the date of request for consultations should be rejected under the ATC.

The Appellate Body arrived at the same conclusion in *US – Underwear*. In that case, it was ruled that a safeguard measure may be applied only prospectively due to the fact Article 6.10 ATC did not make express reference to backdating the effect to some date prior to the promulgation or imposition of such measure.<sup>132</sup> In comparison with the related MFA provisions, the Appellate Body confirmed that the disappearance in the ATC of the earlier MFA express provision for backdating the operative effect of a restraint measure strongly reinforced the presumption that such retroactive application was no longer permissible.<sup>133</sup>

Second, Article 6.6 ATC provided various circumstances where more favourable treatment for different exporting countries should be granted, depending on their domestic economic conditions. Exporting countries eligible for favourable treatment included the least-developed country Members, Members with small textile export volume, developing country Members dependent upon the wool sector and the so-called OPT (Outward Processing Trade) destination countries.<sup>134</sup> Among these countries, the least-developed countries turned out to be the biggest beneficiary of this scheme and favourable treatment granted to other groups appeared to be more restrictive.<sup>135</sup>

For the favourable treatment, the panel in *US-Underwear* established the general principle as follows: “according to the ‘chapeau’ to Article 6.6, the more favourable treatment must be granted, which means that Members availing themselves of the Article 6 transitional safeguard are obliged to do so”.<sup>136</sup> The panel further concluded that the favourable treatment was flexible in form, which could be enforced either through a quota larger than that under Article 6.8 or by imposing a restriction for a period shorter than three years.<sup>137</sup>

#### **2.4.4 Procedural obligations in the preliminary investigation**

Unlike Article 3 of the SGA, which provides explicitly for an investigation by competent authorities of a Member, Article 6 of the ATC did not specify either the organ or the procedure through which a Member makes its determination for safeguard actions. In the *US-Cotton Yarn* dispute, after approving the application of Article 11 DSU on the standard of review under the ATC, the Appellate Body, with regard to the absence of essential provisions on investigation, observed “the above

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<sup>132</sup> *US-Underwear*, Appellate Body Report, n. 115, para. 14.

<sup>133</sup> *Ibid*, para 17.

<sup>134</sup> The OPT involve the temporary export of textile or pre-cut fabrics from the OPT-initiator country to low-wage countries for final assembly, with the finished articles then being re-imported under preferential provisions. For the OPT destination countries, the assembly of imported fabrics into clothing is a simple form of industrial activity. Thus OPT eligibility often acts as a booster for their export-oriented strategies by giving them instant access to high quality inputs and foreign distribution networks. For developed countries, outward processing transactions strengthen the competitive position of domestic suppliers by enabling them to transfer labour-intensive sewing activities in low-wage countries.

<sup>135</sup> Article 6.6 ATC.

<sup>136</sup> *US-Underwear*, Panel Report, n. 92, para. 7.56.

<sup>137</sup> *Ibid*, para. 7.57.

principles concerning the standard of review under Article 11 of the DSU with respect to the Agreement on Safeguards apply equally, in our view, to a panel's review of a Member's determination under Article 6 of the ATC".<sup>138</sup> In other words, investigation procedures mandated in Article 3 SGA should equally apply to the ATC transitional safeguards, which did not mention specific procedure obligations in this regard. In particular, the Appellate Body based this ruling on the ground that "we consider, therefore, that the exercise of due diligence by a Member is all the more important in reaching a determination under Article 6 of the ATC".<sup>139</sup> Furthermore, the same conclusion also arises from the requirement for cumulative application of the WTO rules. Indeed, it has already been argued that WTO panels and the Appellate Body have not hesitated to require investigating authorities in safeguard, textile and anti-dumping matters to exercise considerable due diligence in conducting investigations, even where the textual requirements may be vague or non-existent.<sup>140</sup>

Hence, for the imposition of a transitional safeguard measure under the ATC, investigation has to be carried out in accordance with the same procedural obligations as required under the SGA. In particular, it should essentially include reasonable public notice to all interested parties and public hearings or other appropriate means pursuant to which importers, exporters and other interested parties could present evidence and their views. Moreover, the confidentiality of the information shall also be cautiously protected.<sup>141</sup>

## **2.5 Some remarks on the ATC**

### **2.5.1 Contingent trade protection in T&C**

Trade restraints in T&C during the ATC era consisted of, primarily, import quotas inherited from the MFA and new restrictions imposed in accordance with the relevant ATC and WTO rules. The MFA quotas, after being notified to the ATC through the procedure under Article 2.1, were gradually liberalised through the acceleration mechanism discussed earlier. For the so-called "new restriction", which was widely interpreted by the WTO panel in *Turkey-Textiles* to include even any increase based on the existing quotas,<sup>142</sup> Article 2.4 adopted a rather restrictive approach towards its imposition.<sup>143</sup> In short, new restriction could take the form only of contingency instruments, such as safeguards and anti-dumping, which shall not be

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<sup>138</sup> *US-Cotton Yarn*, Appellate Body Report, n. 96, para.76.

<sup>139</sup> *Ibid.*

<sup>140</sup> Scott Andersen and Christian Lau, 'Hedging hopes with fears in China's accession to the WTO: the transitional special-product safeguard for Chinese exports', *The Journal of World Intellectual Property*, (2002) 5, 405-476, p.466.

<sup>141</sup> Article 3 SGA.

<sup>142</sup> *Turkey - Textiles*, Panel Report, n. 83, para 9.71.

<sup>143</sup> Article 2.4 ATC provides "no new restrictions in terms of products or Members shall be introduced except under the provisions of this Agreement or relevant GATT 1994 provisions".

permitted unless being justified by the ATC and WTO rules on contingent protection. Therefore, apart from the safeguards discussed in the preceding section, new restriction could also be imposed in the case of unlawful trade practice with a notable instance of international dumping sales. However, no sector-specific rules in this area were mentioned in the ATC, which was thus subject to Article XI GATT and the rules under the ADA.

Among different contingency instruments in the T&C sector, safeguard actions, as the only instrument specified under the ATC, were not as popular as expected, especially in comparison with anti-dumping. During the period from January 1, 1995 to December 31, 2006, 64 requests for consultation under Article 6 ATC have been received, which finally resulted in 19 agreed quantitative restrictions and 14 unilateral actions. In contrast, 217 anti-dumping measures in total were imposed during the same period.<sup>144</sup> Given the concentrated utilisation of the ATC transitional safeguards among a small group of Members, most T&C importers still relied on other trade instruments, i.e. MFA quotas and anti-dumping duties. For example, by the end of 2007, the EU has never initiated any safeguard investigation in T&C; meanwhile, more than 80 anti-dumping measures were enforced.<sup>145</sup>

The unpopularity of safeguard actions was also the consequence of the wide use of quantitative restrictions in this sector. During the ATC era, all major importers managed to maintain in place at least 70 per cent of their quotas. This was mainly because they cynically exploited the ATC by including products into the phase-out project that had not actually been subject to any bilateral restraint in the first place. As a result, the majority of the product categories integrated into the WTO framework in the early phases were, generally speaking, the ones already benefiting from quota-free treatment.<sup>146</sup> The convenient access to quantitative restrictions rendered the safeguards rather undesirable in that the former exempts the importing Member from the tasks of proving the domestic serious damage, as well as the investigation obligations. Therefore, T&C imports could be easily controlled through maintaining the quotas in force rather than invoking the transitional safeguards.

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<sup>144</sup> Statistics on safeguard measures, [http://www.wto.org/english/tratop\\_e/safeg\\_e/safeg\\_e.htm](http://www.wto.org/english/tratop_e/safeg_e/safeg_e.htm); Reports of the Committee on Anti-dumping Practices under Article 16.4 of the agreement, [http://www.wto.org/english/tratop\\_e/adp\\_e/adp\\_e.htm](http://www.wto.org/english/tratop_e/adp_e/adp_e.htm).

<sup>145</sup> Tony Heron, 'European trade diplomacy and the politics of global development: reflections on the EU-China bar wars dispute', *Government and Opposition*, (2007) 42, 190-214, p. 200.

<sup>146</sup> Hildegunn Kyvik Nordås, n.75, p.34.

### 2.5.2 The post-ATC quota-free trade in T&C

The predicted trends after the expiry of the ATC included a substantial increase in market shares for China and India and a loss for other exporting countries as well as the domestic producers. In particular, most analyses conclude that China and India will come to dominate world trade in T&C, with post-ATC market shares for China alone estimated at 50 per cent or more.<sup>147</sup> After 2005, despite the major developing exporters have indeed gained considerable increase in market shares in the previous quota-imposing countries, the export surge appears less than anticipated.

It is thus argued that most studies have overestimated the import rise from developing countries, as well as the impact thereof. In general, the studies were mainly focused on the overall lift of import quotas and the consequent changes in relative prices and cost competitiveness. However, the outcome of the final quota phasing-out was also influenced, arguably to a much more significant extent, by the prevailing tariff rates and the preference margins of countries receiving such preferences.<sup>148</sup> Despite the compulsory abolition of T&C quotas by 2005, the WTO does not mandate any commitments on its Members concerning the tariff concession in the same sector. In fact, tariffs on T&C products have frequently remained at a high level even after the reductions of the Uruguay Round. It is not just the situation with the major industrial Members. The large developing-country exporters also apply higher tariffs than in other manufacturing sectors.<sup>149</sup>

In the meantime, the preferential treatment granted by the major importing Members constitutes another factor affecting the import flows. For example, treatment of this type in the T&C sector is manifestly reflected in EU's trade policies. Among its top T&C supplier countries, the EU has concluded Economic Partnership Agreements with Turkey, Tunisia and Morocco, the imports from which were thus free from quotas before 2005 and are subject to more favourable levels of tariffs thereafter.<sup>150</sup>

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<sup>147</sup> Ibid.

<sup>148</sup> Jorg Mayer, n.76, p. 424.

<sup>149</sup> For detailed tariff statistics, see [http://www.wto.org/english/res\\_e/statis\\_e/statis\\_e.htm](http://www.wto.org/english/res_e/statis_e/statis_e.htm).

<sup>150</sup> Agreement establishing an Association between the European Economic Community and Turkey, OJ, L 361, 31/12/1977, p. 1-33; Euro-Mediterranean Agreement establishing an association between the European Communities and their Member States and the Republic of Tunisia, OJ, L 97, 30/03/1998, p. 2 – 183; Agreement in the form of an exchange of letters between the Community and the Kingdom of Morocco under Article 12(1) concerning elimination of the reference prices applied

For other important T&C exporters, such as Bangladesh and India, preferential access to the European market has been granted under EU's Generalised Scheme of Preferences.<sup>151</sup> It is thus submitted that the foregoing elements have played an important role in shaping the trade pattern in the T&C market.

Furthermore, the removal of import quotas did not render the importing Members totally unarmed. Rather, apart from the instruments of high tariff level and preferential treatment to favoured sources, the importing Members also maintain effective protection by virtue of the non-quota contingency measures, such as safeguards and anti-dumping. Indeed, this sector has always been one of the biggest anti-dumping targets among other industries. Since the establishment of the WTO, there have been 252 anti-dumping initiations towards T&C products, ranking fifth among the industrial goods traded.

As to the T&C products of Chinese origin, on the one hand imports from China have substantially increased in the major importing Members, such as the EU and the US; on the other hand, however, apart from the imposition of high-level tariffs and the exclusion from most preferential treatment, these Members did not hesitate to invoke the WTO contingent instruments applicable exclusively to China, namely the T&C-specific safeguards and the NME anti-dumping treatment.<sup>152</sup> Increase in the market share of Chinese products could be easily and effectively blocked in either way. Another approach in the import control against China has also been addressed in those Members. In particular, it has been argued that to reduce the risk associated with overdependence of sourcing from one country, i.e. China, major buyers are likely to expand imports from other low-cost countries, particularly in South Asia.<sup>153</sup>

### ***Section III. Doha Round negotiations in T&C and submissions from the EU***

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by Morocco to imports of certain textile and clothing products, OJ, L 70, 30/03/1998, p. 200 – 201.

<sup>151</sup> Council Regulation 980/2005 applying a scheme of generalised tariff preferences, OJ, L 169, 30/6/2005, p. 1–43; Council Regulation 732/2008 applying a scheme of generalised tariff preferences for the period from 1 January 2009 to 31 December 2011 and amending Regulations 552/97, 1933/2006 and Commission Regulations 1100/2006 and 964/2007, OJ L 211, 6/8/2008, p. 1–39.

<sup>152</sup> For detailed discussion, see Chapter III.

<sup>153</sup> Jorg Mayer, n.76, p.419.

At the end of the implementation period for the tariff reductions of Uruguay Round, the average level of bound tariffs in developed countries was cut down to around 6.5 per cent.<sup>154</sup> Thus, after more than fifty years of progressive liberalisation, most of the developed countries have probably reduced or eliminated all of the “easy” tariffs and are now left with the task of dealing with politically sensitive sectors that were able to escape cuts in earlier GATT rounds.<sup>155</sup> Among others, T&C stands out as a notable example, where the major achievements so far have been the removal of import quotas and the final taking-over of the GATT regime.

Indeed, T&C is one of the areas where sectoral negotiations have taken place during the Doha Round. The sectoral tariff reduction component is a key element in achieving the objectives of non-agricultural market access (NAMA)<sup>156</sup>, which is aimed at reducing, harmonising or as appropriate eliminating tariffs. In particular, it incorporates the reduction or elimination of tariff peaks, high tariffs and tariff escalation, over and above that which would be achieved by the formula modality, especially on products of export interest to developing Members. The formula modality, consisting of the general formula and specific modalities proposed for sectoral initiatives, normally includes provisions on differential treatment for developing country Members, principal sectoral modality, enforcement procedures and product coverage. Participation in sectoral initiatives is on a non-mandatory basis; it is therefore up to WTO Members to attend the sectoral negotiations. However, the participating Members will be bound by the tariff reduction and the concession schedule agreed by a critical mass of all the participants.<sup>157</sup> This approach is of considerable significance in balancing the overall results of the negotiation on the NAMA.

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<sup>154</sup> Andrew Stoler, ‘The central place of market access for the WTO’s development round’, Yasuhei Taniguchi, Alan Yanovich, Jan Bohanes (eds), *The WTO in the Twenty-first Century: Dispute Settlement, Negotiations, and Regionalism in Asia*, Cambridge University Press, 2007, p. 319- 327.

<sup>155</sup> With the end of the WTO-sanctioned quotas on T&C, these tariffs might be even more difficult to cut in the Doha Round. Andrew Stoler, n.140.

<sup>156</sup> Article 16 Doha Development Agenda, available at [http://www.wto.org/english/res\\_e/booksp\\_e/ddec\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/ddec_e.pdf).

<sup>157</sup> Sectoral initiatives currently proposed include: automotive and related parts; bicycles and related parts; chemicals; electronics/electrical products; fish and fish products; forest products; gems and jewellery; hand tools; industrial machinery; open access to enhanced health care; raw materials; sports equipment; toys; and textiles, clothing and footwear. However, unlike other sectors, the draft modality for T&C has not been presented in the Draft Modalities for NAMA. ‘Draft Modalities for Non-agricultural Market Access: Third Revision’, WTO, 10 July 2008, TN/MA/W/103/Rev.2.

Meanwhile, the reduction or elimination of non-tariff barriers (NTBs) is also an integral and equally important part of the NAMA objectives. The T&C industry worldwide continues to face pervasive behind-the-border trade obstacles which can frustrate any additional market access acquired through tariff reductions. If not tackled, these new obstacles will create, for all exporters, an uncertain landscape, which will reduce many of the benefits of the tariff reductions foreseen in the Doha Development Agenda.<sup>158</sup> In most cases, proposals on NTB cover the general horizontal issues and the vertical initiatives with sectoral focuses. In the case of T&C, an Understanding on the Implementation of the Agreement on Technical Barriers to Trade with Respect to the Labelling of Textiles, Clothing, Footwear, and Travel Goods is proposed in the Draft Modalities.<sup>159</sup> However, it is important to point out that the application of NTBs in T&C goes far beyond the excessive requirements in labelling and package. Nowadays, more and more NTBs are created in the so-called grey area of the WTO disciplines in order to cope with an increasingly deregulated T&C market and it has already been argued that there is a risk the NTBs in this sector might serve as a substitute for tariffs as the latter are reduced.

For the EU T&C industry, priority export markets, on which tariff and non-tariff barriers are significant hurdles to an orderly free and fair trade development, include most of the major importing WTO Members, such as China and the US. The European industry urges the Commission to adopt a positive approach during the Doha Round negotiations since its own bound tariffs are the lowest in the world and it is therefore believed that the time has now come for other Members to come to the European levels.<sup>160</sup> Detailed targets and proposals have been received from the industry, the major objective of which is to ensure that all countries, in particular advanced developing countries that are dominant suppliers in this area, should reduce, harmonise and bind their customs duties on T&C at a maximum of 15 per cent for finished products. This should be done with no *a priori* product exclusion and no WTO Member exemption except the least developed countries.<sup>161</sup> With regard to the NTBs, the most damageable barriers faced by the European industry have also

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<sup>158</sup> 'Where does Europe's Textiles and Clothing Industry Stand Today?', EURATEX, Oct 2005, available at [www.euratex.org](http://www.euratex.org).

<sup>159</sup> 'Draft Modalities for Non-agricultural Market Access: Third Revision', n.143, p. 45.

<sup>160</sup> 'A Sectoral Approach for the Textile and Clothing Industries within the DDA', EURATEX, 27 Feb 2006, available at [www.euratex.org](http://www.euratex.org); 'Where does Europe's Textiles and Clothing Industry Stand Today?', n.144.

<sup>161</sup> Ibid.

been raised, which are required to be lifted altogether.<sup>162</sup>

In this context, the EU submitted its proposal at the Doha Round that all Members agree to deeper cuts to the tariff levels, with a view to bringing these tariffs within a narrow common range as close to zero as possible. Furthermore, it proposed that all NTBs as well as the export restrictions on raw materials must also be removed. Under that approach, the special and differential treatment should be accorded only to the least developed countries, excluding the developing countries beneficiaries.<sup>163</sup>

In terms of the sectoral proposals raised at the Doha Round, especially the positions submitted by the EU, several observations could be drawn here.

First of all, the identification, examination and categorisation of NTBs in T&C require further clarification and the proposals for coping with such sectoral barriers should be more specified. So far, proposals have merely covered the issue of labelling and packaging, which are far from sufficient. At the current stage, NTBs in T&C also take place in documentary requirements regarding certificate of origin, licensing requirement and authorisation, lack of transparency in import procedures and barriers in certificate requirements and technical regulations.<sup>164</sup> Therefore, WTO Members should attempt to submit better-defined proposals specifying in detail the most hindering trade obstacles in practice, which is an essential precondition for carrying out effective multilateral negotiation for potential resolution.

Second, according to the EU submissions, special and differential treatment shall no longer apply to developing country Members in T&C and all Members should be bound except the least developed countries.<sup>165</sup> In contrast, it is a common practice under all other sectoral modalities that flexible options are provided for the developing group, which generally include the extended implementation period and

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<sup>162</sup> Other NTBs, which could create an almost impossible wall of costly obstacles for small and medium enterprises lie in the customs valuation and classification, retailing prices, complex labelling requirements and standards, time-consuming customs clearance, pre and post-inspections, security requirements, restrictive access to distribution and payment problems, tariff quota or rules of origin requirement and SPS requirements. ‘Where does Europe’s Textiles and Clothing Industry Stand Today?’, n.144.

<sup>163</sup> Communication from the European Communities, TN/MA/W/11/Add.2, 1 April 2003; Sectoral Negotiations in NAMA, TN/MA/W/97/Rev.1, 20 Dec 2007.

<sup>164</sup> ‘Where does Europe’s Textiles and Clothing Industry Stand Today?’, n.144.

<sup>165</sup> Communication from the European Communities, n.149, para. 9.

raised levels of bound tariffs.<sup>166</sup> This sectoral initiative depriving developing Members of the prerogative stems from the objective of European industry pressing for reciprocity.<sup>167</sup> In particular, it is argued that the European market is one of the most open markets in the world while an overall high level of tariffs and NTBs prevail in the developing country Members.

However, under the Doha Round, the feasibility of complete reciprocity is highly questionable and a more practicable approach refers to the “less than full reciprocity” principle in the reduction commitments. So far, no agreement regarding the definition of “reciprocity” has been achieved among the WTO Members. It is mainly because Members have insisted on using their own yardstick to measure this issue. Many developing Members observe that reciprocity can be interpreted only as a requirement for developing countries that apply the formula to reduce their bound tariff less than developed countries. Other Members argue that the mandate for less than full reciprocity describes the modalities as a whole and that some consideration must be given to the value of reductions in dutiable tariff lines, applied tariffs and tariff peaks.<sup>168</sup> A detailed discussion of the principle of reciprocity goes beyond the scope of this thesis. At this juncture, it is argued that this principle, in the context of the WTO, does not entail equivalent, or unvarying, sectoral tariff reductions. Among all the industrial sectors, it is inappropriate to assess the reciprocity issue only in terms of the tariff reduction in a particular area; and the existence of sectoral imbalance does not affect the reciprocity in terms of the overall trade policies. Therefore, traditional special and preferential treatment for developing country Members should be resumed and maintained in the subsequent T&C negotiations.

## **Chapter conclusions**

The MFA is the first multilateral textile agreement under the GATT regime, which governed international trade in cotton, wool and artificial and synthetic fibres for almost 20 years. As a sub-regime under the multilateral system, it would take precedence over the GATT rules, due to the principles of *lex specialis* and *lex posterior*, where normative conflict arose in the domain thereof. Although having

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<sup>166</sup> ‘Draft Modalities for Non-agricultural Market Access: Third Revision’, n.143, Annex 6.

<sup>167</sup> ‘A Sectoral Approach for the Textile and Clothing Industries within the DDA’, n.146.

<sup>168</sup> Chairman’s Introduction to the Draft NAMA Modalities, WTO, 17 July 2007, available at [http://econpapers.repec.org/paper/esswpaper/id\\_3a1534.htm](http://econpapers.repec.org/paper/esswpaper/id_3a1534.htm).

established fairly commendable targets in trade development and liberalisation, the MFA, to a large extent, failed to reach its objective of quota removal; and consequently protectionist policy remained in control of the trade flows in the textile sector. With regard to the contingency instruments, the MFA introduced a transitional safeguard mechanism. As a major part of the sector-specific trading rules, it was characterised by discriminatory application against low-priced import trade. However, this mechanism was barely invoked in practice.

The failure in sectoral liberalisation, as well as the scarce recourse to the transitional safeguards, was mainly caused by the excessive reliance on bilateral approach under the MFA. In particular, Article 4 allowed for the conclusion of bilateral agreements, which granted remarkable manoeuvrability to the negotiating parties. Consequently, a great number of regional textile agreements entered into force with significant deviations from the MFA, notably in the maintenance of quotas and the use of regional contingency instrument. The liberalisation process expected at the MFA was thus substantially suspended. Therefore, sector restructuring in T&C became an imperative pending issue on the agenda of the WTO Uruguay Round.

Subsequently, the ATC replaced the MFA and came into force in 1995, according to which, WTO Members committed themselves to the complete removal of quotas and the full integration of the T&C sector by the end of 2004. Owing to the principle of cumulative application, the ATC and other WTO rules applied simultaneously and Members must comply with all of them in most cases. However, under two circumstances, the ATC would prevail over the GATT rules as a result of either the application of the General Interpretative Note, or the explicit authorisation included in the former. These are respectively referred to as the situation of conflicts and that of express derogations.

As a marked step forward, the ATC abandoned the bilateralism under the MFA and set up a compulsory deadline on the final market opening-up on January 1, 2005. Obligatory sectoral reform was characterised by the integration programme and the acceleration mechanism. However, the implementation process witnessed considerable implementation flexibility, particularly the discretion in product selection for integration and quota removal. Therefore, without breaking their WTO commitments, major importing Members managed to operate a back-loading policy

against liberalisation. The outstanding examples in this regard included the postponed integration of the most sensitive items and the inflated quota list with additional products, which had been free from restrictions before. Consequently, although the ultimate target of sector opening was achieved on time, 2005 saw a remarkable market shock in T&C. Hence, the experience under both the MFA and the ATC has manifestly illustrated the demands, in terms of an effective and smooth sectoral integration, for the reduced domestic discretion during the implementation process of the transitional mechanism.

With regard to the contingent trade protection, while sharing the same anti-dumping regime as other industries, the T&C sector was conventionally equipped with transitional safeguard mechanisms, i.e. Article 3 MFA and Article 6 ATC. The sector-specific mechanisms presented several features in common, including regional application against selected exporting sources and exemption from compensation and retaliations. It has to be pointed out that these features constituted the major deviations from the standard WTO safeguards, where the fundamental principle of non-discrimination prevails and the interests of exporting Members suffering safeguard measures are, to a certain extent, better recompensed.<sup>169</sup>

Compared with the MFA, policy move towards the general WTO safeguards became evident under the ATC. Article 6 abandoned the MFA benchmark of “market disruption” and the discrimination against low-priced trade practice. Instead, it primarily focused on the import surge causing serious damage or the threat thereof. Furthermore, retroactive application of restrictions was no longer permitted under the ATC and preferential treatment has to be granted to certain supplier countries. However, owing to the widespread maintenance of quantitative restrictions before 2005, recourse to safeguards remained scarce in this sector.

During the post-ATC era, T&C exports from developing countries, whose products used to be subject to restrictive quotas, have considerably increased and gained

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<sup>169</sup> This policy discrepancy does not lead to conflict in the sense of either Article 1.2 DSU or the General Interpretative Note. It is because the transitional safeguards under Article 6 ATC and the standard WTO safeguard mechanism have different coverage amongst T&C products. While the former are concerned with the un-integrated categories, the latter exclusively governs the integrated items. As the panel stated in *Indonesia-Auto*, “we recall that for a conflict to exist between two agreements or two provisions thereof, they must cover the same substantive matter. Otherwise there is no conflict since the two provisions have different purposes”. *Indonesia-Auto*, Panel Report, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, para. 14.29.

sizable market shares in the quota-imposing countries. However, there are some other issues that prevented further export expansion. These consist of the prevailing high level of tariff rates, the preferential treatment towards limited import sources and the frequent use of anti-dumping measures. In the case of China, attention shall also be paid to its WTO-minus commitments in contingency instruments, which will be examined in a subsequent part of this thesis.

The first chapter will be concluded by the following observations. Firstly, with regard to the relationship between the T&C transitional mechanism and the general GATT/WTO system, parallelism, to a certain extent, can be drawn from the debate over the self-contained regimes under international law. In particular, a similar relationship seems to have emerged in the discussion regarding the role of general international law within the WTO system.<sup>170</sup> The report of the International Law Commission on fragmentation of international law provides an authoritative and in-depth analysis in this context. On the one hand, WTO law is often identified as “special” in the sense that rules of general international law are assumed to be modified or even excluded in their administration.<sup>171</sup> On the other hand, however, as the mainstream argument indicates, none of the treaty-regimes in existence today is self-contained in the sense that the application of general international law would be generally excluded.<sup>172</sup> This position has been constantly highlighted in the WTO jurisprudence.<sup>173</sup>

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<sup>170</sup> Scholars of international law have intensely debated these problems mostly under the heading “fragmentation” of international law or “proliferation” of international courts and tribunals. See Gerhard. Hafner, “Risks ensuing from fragmentation of international law”, Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 10, UN Doc. A/55/10 (2000), 321-339, and “Pros and Cons ensuing from fragmentation of international law”, *Michigan Journal of International Law*, (2004) 25, 849-868. Also see Martti Koskenniemi, “Study on the function and scope of the *lex specialis* rule and the question of ‘self-contained regimes’”, UN Doc. A/59/10 (2004), and “Fragmentation of international law: difficulties arising from the diversification and expansion of international law”, Report of the Study Group of the International Law Commission (2007). In the context of the WTO, see Joost Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to Other Rules of International Law*, n.13, and “The role of public international law in the WTO: how far can we go?”, *The American Journal of International Law*, (2001) 95, 535-578.

<sup>171</sup> It has even been suggested that the WTO covered treaties form a closed system, which derive its justification from the theory of comparative advantage, whereas general international law is based on State sovereign. ‘Fragmentation of international law: difficulties arising from the diversification and expansion of international law’, n.14, p.91.

<sup>172</sup> *Ibid.*

<sup>173</sup> As the Appellate Body noted, WTO agreements should not be read “in clinical isolation from public international law”. *US-Gasoline*, Appellate Body Report, WT/DS2/AB/R, p.16; The Appellate Body has frequently sought “additional interpretative guidance, as appropriate, from the general principles of international law”. *US – Shrimp*, Appellate Body Report, WT/DS58/AB/R, para. 151.

Therefore, international law applies generally to the economic relations between WTO members. Such international law applies to the extent that the WTO treaty agreements do not ‘contract out’ from it. To put it another way, to the extent that there is no conflict or inconsistency, or an expression in a covered WTO agreement that applies differently, the customary rules of international law apply to the WTO treaties and to the process of treaty formation under the WTO.<sup>174</sup> There seems, thus, little reason of principle to depart from the view that general international law supplements WTO law unless it has been specifically excluded and that so do other treaties, which should, preferably, be read in harmony with the WTO covered treaties.<sup>175</sup>

The MFA-GATT, or the ATC-WTO, relationship resembled, to a large extent, the connection analysed above. Therefore, at least two functions of the GATT/WTO rules within the transitional mechanism could be confirmed. First, they provide the normative background that comes in to fulfil aspects of its operation not specifically provided by it. Second, they also come to operate if the special regime fails to function properly.<sup>176</sup> These functions are of significant importance during the implementation and interpretation process of the transitional mechanisms which are generally characterised by the textual brevity and vagueness. The relevant WTO jurisprudence illustrated a similar rationale. Where the essential provisions were missing, i.e. the investigation procedure prior to the imposition of safeguard measures, the judicature did not hesitate to apply the corresponding discipline specified in other WTO agreements.<sup>177</sup> Such practice of placing the special mechanism of exceptional nature against the general background of WTO legal framework, to a certain extent, enhanced the multilateral control over the transitional reform.

The second observation relates to the traditional protectionism in T&C. This sector has witnessed what is perhaps the widest use of national instruments in trade restriction. It is the last industry maintaining import quotas, the removal of which did not take place until 2005. With regard to the contingency instrument, it is also one of the most targeted industries in anti-dumping, which thus becomes the most preferred

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<sup>174</sup> *Korea - Government Procurement*, Panel Report, WT/DS163/R, para. 7.96.

<sup>175</sup> ‘Fragmentation of international law: difficulties arising from the diversification and expansion of international law’, n. 14, p.90.

<sup>176</sup> *Ibid*, p.100.

<sup>177</sup> *US-Cotton Yarn*, Appellate Body Report, n. 96, para.76.

sectoral instrument after the quotas. Furthermore, the special safeguard mechanism, maximising the interests of importing Members, has always been an indispensable part of the sector-specific trading regime. However, following the discussion in this chapter, multilateral control over these national instruments was highly permissive, which was partially caused by the fact that the relevant transitional rules were drafted in a rather generic way with evident deficiency in legal certainty and considerable discretion in the domestic enforcement process. As a result, among WTO Members, national T&C policy varies dramatically from one to another.

The coming chapter, therefore, will examine in particular the European regime in this sector. Similar to the situation at the GATT/WTO, the EU established a separated regime governing the T&C trade alongside the general system on imports of other industrial products. In addition, a number of rules have been developed exclusively applicable to products of Chinese origin. The next chapter, after the preliminary discussion on the common commercial policy and the GATT/WTO impact within the EU, will scrutinise its T&C trading system in both aspects.

## **CHAPTER II. EU TRADE POLICY AND THE SPECIAL REGIME IN TEXTILES AND CLOTHING**

Prior to 2005, the EU maintained a separate system governing T&C imports from third countries, which deviated considerably from its general regime for imports of other industrial products. Under the spectrum of the CCP, the T&C regime consisted of instruments at both domestic and international fronts. Therefore, before looking into the EU T&C trading regime, this chapter will first discuss the reception of international law in the EU legal order and the policy foundation of the CCP in the external trade. The former is indispensable in understanding the legal effect of EU's international obligations and commitments, and the latter will investigate the CCP with particular focus on its scope, nature and implementing instruments.

At the international level, the GATT/WTO is the single most important source of law affecting EU's trade policy, the fundamental influence of which has been manifestly demonstrated in the liberalisation process of the T&C sector. The second part of this chapter will thus scrutinise the impact of the GATT/WTO, mainly in terms of the decision-making process of the EU political institutions and the judicial approaches of the European Court<sup>178</sup> towards the legal effect of GATT/WTO law.

Thereafter, discussion will explore the sectoral trade policies in T&C, including, externally, the bilateral textile agreements concluded between the EC and the supplier countries and, internally, the relevant legislation on T&C imports. While the T&C agreements primarily focused on general policy guidance, it is the provisions of EC legislation that directly regulate import activities. Furthermore, other elements involved in the shaping of the T&C regime will also be analysed.

Under the T&C-specific regime, the EU has singled out China from other supplier countries and established differential trading rules in accordance with the agreements concluded between these two parties. The final part of this chapter will introduce and assess the bilateral trade relations in T&C in terms of the policy development at the GATT/WTO.

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<sup>178</sup> The term "European Court" refers to the European Court of Justice (ECJ) or the subordinate court, the Court of First Instance (CFI). In the recent Lisbon Treaty, they have been respectively renamed as the Court of Justice of the European Union and the General Court.

## ***Section I. The reception of international law in the EU legal order and the Common Commercial Policy***

### **1.1 The reception of international law in the EU legal order**

From an international law perspective, the primacy of general international law is well established. As Article 27 VCLT provides, a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. As a result, the conflicting domestic law could not be relied on to exempt the country concerned from its international obligation; and the breach of such obligation would nevertheless incur state responsibility under international law. It has been argued that this primacy is a matter of logic as international law can only assume its role of stabilising a global order if it supersedes particular and local rules.<sup>179</sup>

In the context of EU law, general respect for international law has been confirmed in both the constitutional Treaty and the jurisprudence of the European Court. According to Article 300(7) of the Treaty establishing the European Community (EC Treaty), agreements concluded under the conditions set out in the Article shall be binding on the institutions of the Community and on Member States.<sup>180</sup> This is not only an expression of the vital international law principle *pacta sunt servanda*, but also a Community innovation to extend this binding force to Member States in the case that they are not even the contracting parties to the agreements concerned. Furthermore, the Court has also consistently held that as from the entry into force of the agreement, its provisions form an integral part of the Community legal order.<sup>181</sup> In other words, no further measure transposing international agreements into the domestic legal order is required for them to be part of the EU law.

However, as different constituent elements of the Community legal order, the hierarchy between international law and EU law is another issue, which, although

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<sup>179</sup> Thomas Cottier, 'A theory of direct effect in global law', in Armin von Bogdandy, Petros C. Mavroidis, Yves Mény (eds), *European Integration and International Co-ordination: Studies in Transnational Economic Law in Honour of Claus-Dieter Ehlermann*, London: Kluwer Law International, c2002, p. 102.

<sup>180</sup> The text of the EC Treaty is available at [http://europa.eu/abc/treaties/index\\_en.htm](http://europa.eu/abc/treaties/index_en.htm).

<sup>181</sup> Case 181/73, *Haegeman v Belgium*, [1974] ECR 449; Case 270/80, *Polydor v Harlequin*, [1982] ECR 329.

not explicitly provided in the EC Treaty, has been gradually clarified in case law. In the reception of international law, the European Court has followed different approaches respectively towards the primary and the secondary EU law. Generally speaking, while the founding Treaty and the general principles of EU law cannot be challenged by international law, its primacy over secondary EU acts has been granted in most cases.

### 1.1.1 The relationship between international law and primary EU law

As Article 300 (6) EC provides, the European Parliament, the Council, the Commission or a Member State may obtain the opinion of the Court of Justice as to whether an agreement envisaged is compatible with the provisions of this Treaty. Where the opinion of the Court of Justice is adverse, the agreement may enter into force only in accordance with Article 48 of the Treaty on European Union.<sup>182</sup> This Article actually requires a system for compatibility control *a priori*,<sup>183</sup> which, as established in *Opinion 1/78*, depends not only on provisions of substantive law but also on those concerning the powers, procedure or organisation of the institutions of the Community.<sup>184</sup> There have been several occasions where the Court denied the conclusion of the envisaged international agreements.<sup>185</sup> For instance, in *Opinion 1/91*, the Court observed that to confer that jurisdiction on the Court of the European Economic Area is incompatible with Community law, since it is likely adversely to affect the allocation of responsibilities defined in the Treaties and the autonomy of the Community legal order.<sup>186</sup>

One of the most recent and far-reaching cases highlighting the prevalence of primary EU law is *Kadi*. In that case, the Court observed that “the obligation imposed by an international agreement cannot have the effect of prejudicing the constitutional principles of the EC Treaty, which include the principle that all Community acts must respect fundamental rights, that respect constituting a condition of their lawfulness which it is for the Court to review in the framework of the complete

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<sup>182</sup> Article 48 EU provides for procedures on treaty amendments.

<sup>183</sup> Koen Lenaerts and Eddy De Smijter, ‘The European Union as an actor under international law’, *Yearbook of European Law*, (2000) 19, 95-138, p.98.

<sup>184</sup> *Opinion 1/78 (re: International Agreement on Natural Rubber)*, [1979] ECR 2781, para. 30.

<sup>185</sup> *Opinion 1/76 (re: the European laying-up fund)*, [1977] ECR 741; *Opinion 1/91 (re: the Free Trade Association Agreement)*, [1991] ECR I-6079; *Opinion 2/94 (re: the Accession to the European Convention for the Protection of Human Rights)*, [1996] ECR I-1759.

<sup>186</sup> *Opinion 1/91*, n.8, para. 71-72.

system of legal remedies established by the Treaty”.<sup>187</sup> Therefore, in addition to the factors confirmed in the early case law, namely, the supremacy of the allocation of powers and the autonomy of the Community legal order, fundamental rights constitute another essential element of the EU legal order, the violation of which might invalidate the international law in question.

In sum, the Court thereby applies a somewhat limited version of the monistic approach to rules stemming from international agreements. On the one hand, those rules make up an integral part of Community law and the Community is bound by them; on the other hand, they can nevertheless be overruled by any prior or subsequent norm of primary EU law.<sup>188</sup>

### **1.1.2 The relationship between international law and secondary EU law**

The hierarchical relationship between international law and secondary EU law is mainly featured by the primacy of the former, subject to certain exceptional circumstances. This primacy arises from Article 300 (7) of the EC Treaty, which explicates the binding force of international agreements on Community institutions and Member States. Consequently, in the exercise of their powers, these bodies must ensure compliance with the obligations deriving from such agreements. The duty to respect international rules implies their supremacy over the Community legislation and national law;<sup>189</sup> and the validity of Community legislation may be affected in the case of conflict.

This position was also confirmed by the Court, according to which it is clear from Article 300(7) EC that those agreements have primacy over secondary Community law.<sup>190</sup> Therefore, the legality of the latter could be examined in the light of the former and compliance has to be guaranteed. However, this primacy is not without conditions and exceptions do exist in certain circumstances, which will be analysed in the following part.

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<sup>187</sup> Joined cases C- 402/05 P and C-415/05 P, *Kadi v Council and Commission*, [2008] ECR I-6351, para. 283-285.

<sup>188</sup> Koen Lenaerts and Eddy De Smijter, n.6, p. 106.

<sup>189</sup> Ibid.

<sup>190</sup> Case C-61/94, *Commission v Germany*, [1996] ECR I-3989, para. 52; Case C-311/04, *Algemene Scheeps Agentuur Dordrecht*, [2006] ECR I-609, para. 25; Case C-308/06, *Intertanko and Others*, [2008] ECR I-4057, para. 42; Joined cases C- 402/05 P and C-415/05 P, *Kadi v Council and Commission*, n. 42, para. 306-307.

### 1.1.3 Direct effect of international law in the EU legal order

Before the European Court, international law could be resorted to either as the standards by which to review the lawfulness of Community law, or as source of individual rights, the breach of which could incur litigation brought by individual parties. These two situations are linked to two distinct aspects of international law, namely, direct applicability and direct effect. In particular, direct applicability concerns the hierarchy between international agreement and EU law,<sup>191</sup> which has been discussed in the preceding part. Direct effect, in contrast, refers to the capacity of the rule of international law to confer rights on individuals, which can be enforced before the Court. Put in another way, in the case of an explicit conflict between domestic law and international rules, an individual may challenge the domestic provision on the basis of infringement of his right granted by the international rules concerned, or on the basis of the state's obligation under the invoked international agreement.<sup>192</sup> Indeed, direct effect is a fundamental characteristic of the EU law in terms of its legal effect in the national legal system of the Member States, the decisive condition of which refers to the wording thereof is sufficiently precise, clear and unconditional.<sup>193</sup> However, as will be discussed later, a doctrine of direct effect of international law needs to look behind and beyond this traditional criterion.<sup>194</sup>

When examining the effect of international law, the Court appeared to have combined the issue of direct applicability and that of direct effect. In particular, for international agreements, in the light of which the legality of Community law cannot be examined, their direct effect was also excluded. To date, the Court has been fairly positive in granting direct applicability/effect to international agreements concluded by the EU, including association agreements<sup>195</sup>, free trade agreements,<sup>196</sup> partnership and cooperation agreements<sup>197</sup> and cooperation agreements<sup>198</sup>. There are,

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<sup>191</sup> Koen Lenaerts and Eddy De Smijter, n.6, p. 105.

<sup>192</sup> Thomas Cottier, n.2, p. 105.

<sup>193</sup> Case 32/84, *Van Gend & Loos NV v Inspecteur der Invoerrechten en Accijnzen, Enschede*, [1985] ECR 779.

<sup>194</sup> Thomas Cottier, n.2, p. 105.

<sup>195</sup> Case C-63/99, *The Queen v Secretary of State for the Home Department*, [2001] ECR I-6369; Case C-235/99, *The Queen v Secretary of State for the Home Department*, [2001] ECR I-6427.

<sup>196</sup> Case C-104/81, *Hauptzollamt Mainz v. C.A. Kupferberg & Cie*, [1982] ECR 3641.

<sup>197</sup> Case C-265/03, *Igor Simutenkov v Ministerio de Educación y Cultura and Real Federación Española de Fútbol*, [2005] ECR I-2579.

<sup>198</sup> Case C-18/90, *Office national de l'emploi v Bahia Kziber*, [1991] ECR I-199; Case C-58/93, *Zoubir Yousfi v Belgian State*, [1994] ECR I-1353.

nevertheless, limited but notable exceptions: the GATT/WTO and the UNCLOS.<sup>199</sup> The GATT/WTO case will be examined in detail in the subsequent discussion. Regarding the UNCLOS, the Court, in *Intertanko*, observed that “UNCLOS does not establish rules intended to apply directly and immediately to individuals and to confer upon them rights or freedoms capable of being relied upon against States...it follows that the nature and the broad logic of UNCLOS prevent the Court from being able to assess the validity of a Community measure in the light of that convention”.<sup>200</sup> It is thus clear from this statement that the Court excluded the UNCLOS from both the primacy over EU law and the capacity of being invoked by private parties. The Court would examine the validity of Community legislation in the light of an international agreement only where the nature and the broad logic of the latter do not preclude this and, in addition, the provision under that agreement appears, as regards their content, to be unconditional and sufficiently precise.<sup>201</sup> Therefore, two conditions have been mandated for international law to be invoked as the criterion of legality review, or the source of individual rights: it is not satisfactory that the provision of international agreement is drafted with sufficient precision, the spirit, the general scheme and the terms of that agreement must also be taken into account.<sup>202</sup>

The other exception where the Court declined the direct applicability/effect is the GATT/WTO, which will be scrutinised in detail in the next section. However, its impact upon the EU is nevertheless hard to be overestimated in both political and judicial terms. During the implementation process, the EU institutions undertake different roles: while the European Court acts as the gatekeeper guarding the autonomy of the Community legal order and determining the specific effects of WTO law on EU law,<sup>203</sup> others, especially the Commission, promote WTO law as the primary standards in formulating the trade policies.

## **1.2 The Common Commercial Policy**

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<sup>199</sup> Joint cases 21/72 and 24/72, *International Fruit Company NV and others v Produktschap voor Groenten en Fruit*, [1972] ECR 1219; Case C-149/96, *Portugal v Council*, [1999] ECR I-8395; Case C-308/06, *Intertanko and others v Secretary of State for Transport*, n.13.

<sup>200</sup> Case C-308/06, *Intertanko and others v Secretary of State for Transport*, n.13, para. 65.

<sup>201</sup> *Ibid*, para.42.

<sup>202</sup> Case C-280/93, *Germany v Council*, [1994] ECR I-4973, para. 105.

<sup>203</sup> Francis Snyder, ‘The gatekeepers: the European courts and WTO law’, *Common Market Law Review*, (2003) 40, 313-367, p.362.

Articles 131-133 of the EC Treaty<sup>204</sup> stipulate the general principles of the CCP, which is the basic conduit for the exercise of the EU's external trade policy and an important pillar for external relations. In general, it is based on a set of uniform rules under the customs union and the common customs tariff and governs the commercial relations with non-EU countries. As Article 131 provides, "by establishing a customs union between themselves Member States aim to contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and the lowering of customs barriers. The common commercial policy shall take into account the favourable effect which the abolition of customs duties between Member States may have on the increase in the competitive strength of undertakings in those States". Therefore, the link between the emerging external trade policy and the operation of the common market constitutes the most significant element in the EU trade spectrum, which should thus be borne in mind throughout the following discussion of the CCP.

### **1.2.1 The scope of the CCP**

As Article 133 (1) EC provides, "the common commercial policy shall be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies". According to this Article, the CCP covers not only measures aimed at trade liberalisation, but also those for market protection. On the one hand, during the process of globalisation, the CCP has evolved with the aim of harmonious development of world trade and the opening of the markets under the multilateral framework of the WTO. On the other hand, this policy also provides the constitutional basis for the trade defence actions, which protect the common market and European businesses from unlawful, as well as unexpected, trading practices of third countries. In any event, the CCP should in essence be geared towards trade liberalisation and should not simply be an instrument of trade protection.<sup>205</sup> This is simply because Community trade policy should be understood under the same liberal

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<sup>204</sup> Analysis of the CCP in this thesis is based on the consolidated version of the Treaty after the Nice amendments. For the purpose of this thesis, it will not cover the fields of trade in services and the commercial aspects of intellectual property. As regards the recent Lisbon amendments, a brief introduction will be provided in the subsequent section.

<sup>205</sup> Piet Eeckhout, *External Relations of the European Union*, Oxford University Press, 2004, p. 348

fundamentals underpinning today's world trading system. Furthermore, the wording of Article 133 EC makes it rather clear that the enumeration of activities laid down therein, as within the scope of CCP, is merely indicative; and this conclusion indeed has given rise to the longstanding debate over the scope of the CCP.<sup>206</sup>

In this regard, the overall picture developed by the European Court could be delineated as follows: at the early stage of the 1970s and 1980s, the ECJ emphasised on an expansive and broadly construed foundation for the CCP. In particular, the Court confirmed its similarity with the commercial measures of a sovereign state,<sup>207</sup> its dynamic nature<sup>208</sup> and its coverage ranging from autonomous to conventional measures<sup>209</sup>. After consolidating this foundation, the Court, in cases in the 1990s, began to build up the outer limits and began to prove that the broadly construed CCP is by no means an all-encompassing policy in the Community's external relations. This shift is clearly reflected in *Opinion 1/94*, *Opinion 2/00* and *Case C-281/01* where the Court was asked to rule on the policy interactions between the trade and related policies.<sup>210</sup>

As regards the implementing instruments under the realm of the CCP, the Court, in *Opinion 1/75*, ruled that "in the course of taking the measures necessary to implement the principles laid down in the provisions concerning the common commercial policy...the Community is empowered, pursuant to the powers which it possesses, not only to adopt internal rules of Community law, but also to conclude agreements with third countries pursuant to Article 113 (2) and Article 114 of the (EEC) Treaty".<sup>211</sup> A commercial policy is in fact made up of the combination and interaction of internal and external measures, without priority being taken by one over the others.<sup>212</sup> Among various CCP instruments, the internal legislation is usually referred to as autonomous commercial measures while the international agreements are generally addressed as contractual commercial instruments.

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<sup>206</sup> Panos Koutrakos, 'I need to hear you say it: revisiting the scope of the EC common commercial police', *Yearbook of European Law*, (2003) 22, 407-433, p.408.

<sup>207</sup> *Opinion 1/75 (re: OECD Local Cost Standard)*, [1975] ECR 1355.

<sup>208</sup> *Opinion 1/78*, n.7; *Case 45/86, Commission v Council*, [1987] ECR 1493.

<sup>209</sup> *Opinion 1/75*, n.30.

<sup>210</sup> *Opinion 1/94 (re: WTO Agreements)*, [1994] ECR I-5267; *Opinion 2/00 (re: Conclusion of the Cartagena Protocol on Living Modified Organisms)*, [2001] ECR I-9713; *Case C-281/01, Commission v. Council*, [2002] ECR I-12049.

<sup>211</sup> *Opinion 1/75*, n.30.

<sup>212</sup> *Opinion 1/75*, n.30.

### 1.2.2 The nature of the CCP

Article 133 EC requires that the CCP be based on uniform principles, which are thus deemed as the primary characteristic of the CCP arising directly from the Treaty text. Jurisprudence has further developed the Court's understanding in this regard, which highlighted the exclusivity of the Community competence in the CCP issues. As the most significant characteristics of the CCP, the exclusivity concerns the constitutional question as to the nature of the power granted to the Community, and the uniformity goes to the substantive content of the policy and the conceptual content of 'uniform principles' therein.

The significance of the uniformity in CCP can be traced back to the effective operation of the internal market. In particular, the principle of uniformity requires all essential rules concerning external trade to be adopted by the Community, which should lay down a unified Community regime for both import and export activities of the Member States. According to the assimilation principle of the internal market, all goods imported from third countries shall fully benefit from the internal market once they have cleared customs;<sup>213</sup> this principle can function effectively only in the presence of a unified external trade regime. It is because, if the CCP were to lay down that a particular non-Community product cannot be imported into a particular Member State but can be imported into some or all other Member States, then free circulation in the internal market could be used for the purpose of circumventing the prohibition on importation, and the differential policy would be defeated.<sup>214</sup>

The exclusivity of the CCP originated and has been developed solely in case law since nowhere does the EC Treaty provide for any indication on this issue. It was first put forward by the Court in *Opinion 1/75*, where it ruled that "the provisions of Articles 113 and 114 concerning the conditions under which, according to the (EEC) Treaty, agreements on commercial policy must be concluded show clearly that the exercise of concurrent powers by the Member States and the Community in this matter is impossible".<sup>215</sup> In that case, the Court mainly based its ruling on the need to defend the common interests of the Community in the operation of the common

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<sup>213</sup> Piet Eeckhout, *The European Internal Market and International Trade: a Legal Analysis*, Clarendon Press, Oxford, 1994, p.148.

<sup>214</sup> Ibid.

<sup>215</sup> *Opinion 1/75*, n.30.

market.<sup>216</sup> The Court also pointed out the repercussions of non-exclusive competence as the risks in the competition distortion, the common interests, the institutional framework of the Community and the mutual trust within the Community.<sup>217</sup>

However, it is confirmed in the case law that the lack of uniformity in the CCP has always been the case during the previous 30 years of its development. In the *Donckerwolke* case, the Court observed that, despite the expiry of the transitional period, the CCP had not in fact been complete, as it was possible for different rules to apply to products originating in a third country when they originally entered the Community.<sup>218</sup> In the later *Tezi* case, the Court reiterated its ruling in *Donckerwolke* with particular reference to the non-unified situation in the sector of T&C.<sup>219</sup> Furthermore, the amendments to the CCP introduced by the Treaty of Nice rendered the issue of uniformity even more ambiguous. According to the post-Nice CCP, particularly the new part in paragraphs 5 – 7 of Article 133, in the areas of service and intellectual property rights, the Member States were entrusted with competence in negotiating and concluding international agreements insofar as such agreements comply with Community law and other relevant international agreements.<sup>220</sup> In other

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<sup>216</sup> In that case, it was ruled that “such a policy is conceived in that Article in the context of the operation of the common market, for the defence of the common interests of the Community, within which the particular interests of the Member States must endeavour to adapt to each other...quite clearly, however, this conception is incompatible with the freedom to which the Member States could lay claim by invoking a concurrent power, so as to ensure that their own interests were separately satisfied in external relations, at the risk of compromising the effective defence of the common interests of the Community”. Opinion 1/75, n.30.

<sup>217</sup> “Any unilateral action on the part of the Member States would lead to disparities in the conditions for the grant of export credits, calculated to distort competition between undertakings of the various Member States in external markets...To accept that the contrary were true would amount to recognising that, in relations with third countries, Member States may adopt positions which differ from those which the Community intends to adopt, and would thereby distort the institutional framework, call into question the mutual trust within the Community and prevent the latter from fulfilling its task in the defence of the common interest.” Opinion 1/75, n.30.

<sup>218</sup> In particular, it was ruled “under Article 113 of the (EEC) Treaty this unification should have been achieved by the expiry of the transitional period and supplanted by the establishment of a common commercial policy based on uniform principles. The fact that at the expiry of the transitional period the Community commercial policy was not fully achieved is one of a number of circumstances calculated to maintain in being between the Member States differences in commercial policy capable of bringing about deflections of trade or of causing economic difficulties in certain Member States”. Case 41/76, *Criël, nee Donckerwolke et al. v Procureur de la République au Tribunal de Grande Instance, Lille et al.*, [1976] ECR 1921, para. 27.

<sup>219</sup> In particular, it was ruled that “although, as regards products originating in non-member countries which are parties to the multi-fibre arrangement, Regulation 3589/82 is undoubtedly a step towards the establishment of a common commercial policy based on uniform principles, it does not appear that the system established by that Regulation has brought about complete uniformity as regards conditions of importation for the products in question”. Case 59/84, *Tezi Textiel BV v Commission*, [1986] ECR 887, paras. 36-37.

<sup>220</sup> In particular, Article 133 (5) EC preserved Member States’ competence in the field of trade in services, and the commercial aspects of intellectual property. Article 133 (6) explicitly confirmed their competence in trade in culture, audiovisual, social, education and health services. Meanwhile, both provisions identify the existence of Community competence in those areas although not exclusive in

words, instead of an expansion of exclusive competence, the post-Nice CCP presents the preservation of shared competence, together with a rule designed to avoid conflict.<sup>221</sup> However, the recent Lisbon Treaty brought in a notable breakthrough in the sense that the exclusivity of the CCP is expressly resumed without any compromise and exception. At the current stage, it is still too soon to envisage the influence that this “textual” exclusivity might have upon EU’s trade practice, as well as its influence in the future development of the case law.

With regard to the autonomous trading regime, the policy adopted pursuant to Article 133 EC was anything but uniform, as the areas of import and export rules illustrate only too clearly.<sup>222</sup> One noticeable instance was the existence of the national quotas and the EC sub-division system of global quotas before 1993. This system prevailed in the sectors where the national industries were deemed too weak and too sensitive to directly compete with foreign products, i.e. the T&C, agricultural products and the automobiles. The sub-division system will be discussed in detail in the subsequent section. Here, suffice it to say, prior to the early 1990s, not only had the Member States the discretion to impose import restriction on their own initiative, the EC global quotas also had to be divided into various national shares to meet the diverse requirements among them.

Owing to the close link between the two fronts of the EU trade spectrum, namely, the link between the external trade policy and the operation of the common market, the uniformity and exclusivity of the CCP are further influenced by the parallel development of the internal market. On the one hand, the completion of the internal market in 1992 brought it an important step forward towards the uniformity of the CCP an outstanding example is the lifting of the national quotas enforced by the Member States. On the other hand, however, the absence of comprehensive uniformity in the internal market defines similar situations externally. The internal non-uniformity is mainly due to the new approach of harmonization started in the early 1990s, which does not entirely pre-empt Member States’ regulatory choices.<sup>223</sup> If the logic behind the uniformity of the CCP in external trade policy is driven by the

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nature.

<sup>221</sup> Marise Cremona, ‘A policy of bits and pieces? The Common Commercial Policy after Nice’, *Cambridge Yearbook of European Legal Studies*, (2001) 4, 61-91, p. 85.

<sup>222</sup> Panos Koutrakos, ‘The elusive quest for uniformity in EC external relations’, *Cambridge Yearbook of European Legal Studies*, (2001) 4, 243 -271, p. 251.

<sup>223</sup> For detailed discussion, see Section 4.2.

desire to create an internal market, we should not be surprised to find that where there are gaps in the uniformity or harmonisation of policy internally, there are also gaps in the CCP's uniform principles.<sup>224</sup>

In this regard, the Court also expressed a similar position and thus rendered the notion of uniformity very flexible in the context of the internal market. To start with, it is settled case law that, in the absence of Community harmonisation of legislation, the Member States have the right to make their own decisions regarding the regulation of markets.<sup>225</sup> In the *Keck* case, it was further ruled that “the application to products from other Member States of national provisions restricting or prohibiting certain selling arrangements is not such as to hinder trade between Member States, within the meaning of that definition, so long as those provisions apply to all relevant traders operating within the national territory and so long as they affect in the same manner, in law and in fact, the marketing of domestic products and of those from other Member States”.<sup>226</sup> In essence, what underlies *Keck* is the realisation that there is a limit, albeit a difficult one to define, to what the establishment of the internal market in the current development of EC law may entail in terms of uniformity of national measures.<sup>227</sup>

The outer limits of Community competence in the internal market were later clearly drawn out in *Tobacco Advertising*. In that case the Court found that the express wording of Article 95 EC and the principle of attributed powers embodied in Article 5 EC prevent the former from serving as a general power for the Community to regulate the internal market; rather, the measure to be adopted on such legal basis must “genuinely” have as its object the improvement of the conditions for the establishment and functioning of the internal market.<sup>228</sup> In constitutional terms, the

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<sup>224</sup> According to the new approach of harmonisation around 1992, it would be mistaken to assume that the new approach was entirely uniform. The Community might regulate the relevant field, and thereby pre-empt inconsistent national rules. At the same time, there could be partial regulation which left some issues for national law. Other areas might not be subject to Community regulation at all, because of the difficulty of reaching agreement, or because of lack of time. Catherine Barnard and Joanne Scott, *The Law of the Single European Market: Unpacking the Premises*, Oxford: Hart, 2002, p.359.

<sup>225</sup> Case 41/76, *Criel, nee Donckerwolke et al. v Procureur de la Republique au Tribunal de Grande Instance, Lille et al.*, n.41, para 27; Case 59/84, *Tezi Textiel BV v Commission*, n. 42, paras 36-37.

<sup>226</sup> Joined cases C-267/91 and C-268/91, *Criminal proceedings against Bernard Keck and Daniel Mithouard. References for a preliminary ruling: Tribunal de grande instance de Strasbourg – France*, [1993] ECR I-6097, para. 16.

<sup>227</sup> Panos Koutrakos, n.45, p. 263.

<sup>228</sup> Christophe Hillion, ‘Tobacco advertising: if you must, you may’, *Cambridge Law Journal*, (2001) 60, 486-489.

Court brings the principle of limited powers back to the centre of the Community legal order and challenges the perception that the establishment of the internal market is an all-encompassing process impinging upon all aspects of market regulation.<sup>229</sup>

In sum, by starting with the sanctioning of various arrangements applied by the Community institutions and the Member States, the Court has gradually reached the conclusion that Community competence in the internal market is limited and shared in nature. Due to competence enjoyed by the Member States in the same context, diversity of legislation is an inherent trait rather than an exception; and comprehensive uniformity in the internal market is neither required nor possible. Therefore, it can by no means be assumed that the completion of the internal market during the 1990s would be coupled with a consequent CCP based on fully unified common rules.

### **1.2.3 The recent Lisbon amendments**

Owing to the considerable amount of case law and a series of Treaty amendments, the CCP has become a highly complicated regime in the EU legal order, especially as regards the scope and nature of Community competence in trade issues. In terms of policy clarification, the amendments brought in by the Lisbon Treaty are commendable. Insofar as the CCP is concerned, the Lisbon Treaty not only presents a substantive summary of policy development to date; more importantly, through refined and more elaborate texts, it incorporates many controversial issues into the constitutional treaty with a clear conclusion.<sup>230</sup> In particular, it explicitly categorises the CCP into the exclusive competence of the EU<sup>231</sup>, confirms its scope to embrace the major WTO issues<sup>232</sup> and streamlines the procedures to conclude international agreements in this area<sup>233</sup>. Among others, one of the most significant modifications is the expansion of the policy coverage, which now goes beyond traditional trade issues in tariffs, goods, services, related intellectual property rights and further includes

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<sup>229</sup> Panos Koutrakos, n.45, p. 266.

<sup>230</sup> The relevant Lisbon amendments in the CCP are provided in Article 5 of the Treaty on European Union (TEU), Articles 206 and 207 of the Treaty on the Functioning of the European Union (TFEU). Full text is available at [http://europa.eu/lisbon\\_treaty/full\\_text/index\\_en.htm](http://europa.eu/lisbon_treaty/full_text/index_en.htm).

<sup>231</sup> Article 5 TEU.

<sup>232</sup> Article 207 TFEU.

<sup>233</sup> *Ibid.*

foreign direct investment (FDI) as an essential part of the CCP.

### **1.3 The CCP instruments: contractual vs. autonomous measures**

As established in case law<sup>234</sup>, two types of instruments are widely used by the EU in shaping its trade policies. Such rules may be included in treaties or agreements between the Community and third countries; and they may also flow from internal Community legislation.<sup>235</sup> In most cases, the contractual instruments in the form of international agreements are enforced within the EU through the adoption of autonomous CCP measures. This is the typical paradigm in EU's implementation of its commitments at the GATT/WTO, i.e. the interaction between Article VI GATT and the ADA, on the one hand, and the so-called Basic Anti-dumping Regulation,<sup>236</sup> on the other. In the T&C sector particularly, contractual instruments before 1995 mainly consisted of the bilateral textile agreements concluded between the EC and the supplier countries and the MFA, which was later replaced by the ATC.

At this juncture, a natural question to be addressed concerns the relationship between the two categories of CCP instruments, i.e. how the contractual commitments influence the formulation of autonomous actions and what if a discrepancy arises between them. The following part attempts to provide the answers starting with the discussion of the interaction between the EU trade regime and the GATT/WTO system. Indeed, the latter is indisputably the most momentous source of the EU's obligations in international trade and has acquired a central role in the shaping of internal and external policies.

## ***Section II. The GATT/WTO impact on EU trade policy***

Discussion in this section will explore the impact of the GATT/WTO on the EU

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<sup>234</sup> Opinion 1/75, n.30.

<sup>235</sup> Piet Eeckhout, n.28, p. 355.

<sup>236</sup> The term "Basic Anti-dumping Regulation" is in contrast with the numerous EU regulations imposing specific anti-dumping duties on certain imported products. The Basic Anti-dumping Regulation is mainly based on the relevant WTO rules delineating the EU anti-dumping disciplines in general terms. It has experienced a series of amendments and the current codified version refers to Regulation 1225/2009 on protection against dumped imports from countries not members of the European Community, OJ, L 343, 22/12/ 2009, p. 51-73.

legislation and diplomacy process, with particular emphasis on the judicial enforcement of GATT/WTO law, the enforcement not only of provisions in the multilateral agreements but also of rulings issued by the WTO judicatures.

### **2.1 WTO standards: the mainstay of EU trade policy**

In general, the political institutions of the EU have followed a proactive approach towards the WTO. The term “proactive” defines a position which is not limited to the observation of the obligations undertaken by the EU and the Member States under the WTO agreements but is perceived to promote WTO law as the standard for the conduct of international trade externally and the benchmark for the adoption of internal legislation.<sup>237</sup> It is thus uncontested that WTO law has become the mainstay of EU’s trade policy.

With regard to the internal legislative process, it is now common practice for the preamble of EU legislation to make clear reference to relevant WTO rules and confirm the compliance thereof. Under this explicit aim of WTO conformity, most trade legislation is presumed to be in accordance with WTO law.<sup>238</sup> At the external front, the EU’s proactive approach is notably reflected in the introduction and the promotion of WTO rules in its trade relations with non-WTO members. By treating WTO and non-WTO members alike, the WTO agreements have become the common vocabulary for the EU’s conduct of international trade.<sup>239</sup>

As the major executive in trade practice, the Commission regularly interprets WTO law in charting policy, drafting legislation, negotiating mutually agreed solutions with the EC’s trading partners and interpreting EC law.<sup>240</sup> It has even been argued that in the cases of general and ambiguous norms in WTO agreements, the Community institutions might add their own gloss or dimension to the rules within the interpretative process, which may lead, if not necessarily to over-compliance, at least to results which do not seem to flow inexorably from the text of the WTO.<sup>241</sup>

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<sup>237</sup> Antonis Antoniadis, ‘The European Union and WTO law: a nexus of reactive, coactive, and proactive approaches’, *World Trade Review*, (2007) 6, 45–87.

<sup>238</sup> Francis Snyder, n.26, p.316.

<sup>239</sup> Antonis Antoniadis, n.60, p.79.

<sup>240</sup> Francis Snyder, n.26, p.318 -319.

<sup>241</sup> Gráinne de Búrca and Joanne Scott, *The EU and the WTO: Legal and Constitutional Aspects*, Oxford: Hart, 2001, p. 12.

## **2.2 Legal enforcement of WTO law in the EU**

In spite of the consistent denial of the direct applicability/effect, the Court nonetheless opened other side passages for the GATT/WTO rules to be judicially guaranteed or enforced within the Community legal order. The coming discussion will provide a succinct review of major case law, including not only those which explicitly deprive the GATT/WTO of the competence to assess the legality of EU law, but also the three exceptional circumstances where the same competence is indeed permitted by the Court. It has been argued that, together, all the exceptions may prove nearly as effective as direct effect in integrating WTO law into EU law.<sup>242</sup>

### **2.2.1 *Jurisprudence constante* in the lack of direct applicability/effect**

The Court constantly holds the position that both GATT 1947 and the WTO are excluded from the rules in the light of which the legality of EU law could be accessed. During the GATT era, it was the judgments in *International Fruit* and *Germany* that pointed up the Court's proposition.<sup>243</sup> In *International Fruit*, regarding the fact that the EC was not a contracting party to GATT 1947, the Court opined that "in so far as under the EEC Treaty the Community has assumed the powers previously exercised by Member States in the area governed by the general agreement, the provisions of that agreement have the effect of binding the Community".<sup>244</sup> When it came to the question of direct effect, the Court was mainly concerned with the great flexibility of the provisions under the GATT. In particular, the Court highlighted the possibility of derogation in the form of safeguard measures when confronted with exceptional difficulties and the settlement of conflicts between the contradicting parties. Eventually, it arrived at the conclusion that the GATT was not capable of conferring on citizens of the Community rights which they can invoke before the courts.<sup>245</sup>

Hence, as an action brought by a private party, *International Fruit* ruled out the chance of direct effect for GATT 1947. In the later *Germany* case, the Court further

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<sup>242</sup> Francis Snyder, n.26, p.362.

<sup>243</sup> Joint case 21/72 and 24/72, *International Fruit*, n.22; Case C-280/93, *Germany v Council*, n.25.

<sup>244</sup> Joint case 21/72 and 24/72, *International Fruit*, n.22, para 18.

<sup>245</sup> *Ibid*, paras 21-27.

shed light on the issue of direct applicability in an action initiated by a Member State challenging the lawfulness of a Community measure. In that case, the features of GATT 1947 raised in *International Fruit* also precluded the Court from taking the relevant provisions into consideration to assess a regulation in an action brought by a Member State.<sup>246</sup> According to the Court, an obligation to recognise such provisions as rules of international law which are directly applicable in the domestic legal systems of the contracting parties cannot be based on the spirit, general scheme or terms of the GATT.<sup>247</sup>

Subsequent to the entry into force of the WTO in 1995, there have been enquiries as to whether the new policy development injected at the Uruguay Round, especially the brand-new dispute settlement system, should lead to a review or even a change of position in the previous understanding of direct applicability/effect. An explicit response from the Court was delivered in the Portuguese textile case, where it was ruled that “having regard to their nature and structure, the WTO agreements are not in principle among the rules in the light of which the Court is to review the legality of measures adopted by the Community institutions”.<sup>248</sup> That was a case concerning the annulment of a Council Decision on the conclusion of Memoranda of Understanding between the EC and Pakistan and the EC and India on market access for textile products. Portugal argued that the Council Decision was in breach of the WTO, especially GATT 1994, the ATC and the Agreement on Import Licensing Procedures. In the judgement, the Court first confirmed the significant improvements of the WTO from GATT 1947, particularly the strengthening of the safeguard system and the dispute settlement mechanism.<sup>249</sup> However, this, according to the Court, did not change the fundamental nature of this multilateral system as a negotiation-based forum.<sup>250</sup> In particular, the Court declined the direct effect for two reasons. First of all, the WTO Dispute Settlement Understanding (DSU) provides the chance for negotiation and allows mutually agreed compensation as a temporary resolution substituting the withdrawal of the WTO-inconsistent measure. Thus, if the European Court were then to declare the Community measures to be null due to a violation of WTO law, the Community legislature or executive would lose opportunities to find an alternative solution, even temporarily, in order to bring their legal position in

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<sup>246</sup> Case C-280/93, *Germany v Council*, n.25, para. 109.

<sup>247</sup> *Ibid.*, para. 110.

<sup>248</sup> Case C-149/96, *Portugal v Council*, n.22, para. 47.

<sup>249</sup> *Ibid.*, para. 36.

<sup>250</sup> *Ibid.*

conformity with their WTO obligations.<sup>251</sup> In other words, imposing upon Court the obligations to annul internal rules, which had been found to be incompatible with the WTO, would deprive the legislative and executive bodies of the possibility of searching for negotiated but temporary solutions before the withdrawal or amendment of the measure condemned. Second, the Court also noted that the WTO is still founded, like GATT 1947, on the principle of negotiation with a view to “entering into reciprocal and mutually advantageous arrangements”; and as a matter of fact, none of the most important commercial partners of the Community has so far allowed direct effect of the WTO law. Therefore, granting this effect would risk disuniform, or unbalanced application of the WTO rules and deprive the legislative or executive organs of the Community of the scope for manoeuvre enjoyed by their counterparts in the Community's trading partners.<sup>252</sup>

Therefore, there is, in the reasoning of the Court, a clear shift of emphasis from the “great flexibility” of GATT 1947 in general towards the nature of the WTO as a forum of negotiation aiming at a system of reciprocal and mutually advantageous arrangements.<sup>253</sup> In essence, the Portuguese textile case indicated that even if provisions of the WTO are sufficiently clear, precise and unconditional, the general nature and the spirit of this multilateral system still need to be taken into account as indispensable criteria in the test of direct effect, in terms of which the WTO agreements are not competent.

However, according to recent case law, the lack of direct effect does not prevail over the entire domain of the WTO, particularly in the case where the competence falls on the Member States rather than the Community.<sup>254</sup> In *Merck Genéricos*, the Court observed that Article 33 of the TRIPs Agreement forms part of a sphere in which the Member States remain principally competent; the Community law therefore neither requires nor forbids the legal order of a Member State to accord to individuals the right to rely directly on a rule laid down in the TRIPs Agreement or to oblige the courts to apply that rule of their own motion.<sup>255</sup> It is thus not contrary to Community

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<sup>251</sup> Ibid, paras. 37-40.

<sup>252</sup> Ibid, paras. 42-46.

<sup>253</sup> Allan Rosas, ‘Case C-149/96, *Portugal v. Council*. Judgment of the Full Court of 23 November 1999’, *Common Market Law Review*, (2000) 37, 797-816, p. 815-816.

<sup>254</sup> Case C-431/05, *Merck Genéricos - Produtos Farmacêuticos Lda v Merck & Co. Inc. and Merck Sharp & Dohme Lda*, [2007] ECR I-7001.

<sup>255</sup> Ibid, para. 34.

law for the TRIPS provision in that case to be directly applied by a national court.<sup>256</sup> Therefore, the opportunity is open for WTO rules in these areas, subject to the conditions provided for by national law, to have direct effect within the EU, in particular, within the national legal system of the Member States concerned.

Furthermore, the foregoing judgments denying direct applicability/effect of the GATT/WTO did not render the rules thereof irrelevant to EU law. It was also in those judgments that the Court constantly emphasised the circumstances where the Court could carry out the legality review of the Community act in light of the multilateral trading rules.<sup>257</sup> In particular, “it is only where the Community intended to implement a particular obligation assumed in the context of the GATT/WTO, or where the Community measure refers expressly to the precise provisions of the GATT/WTO agreements, that it is for the Court to review the legality of the Community measure in question in the light of the WTO rules”.<sup>258</sup> These “side passages” are respectively addressed as the transposition, or implementation, exception and the clear reference exception.<sup>259</sup> From a practical perspective, the European Court has recognised the explicit intention to follow WTO law in the area of anti-dumping and in the context of New Commercial Policy Instrument,<sup>260</sup> which was succeeded by the so-called Trade Barriers Regulation.<sup>261</sup>

### 2.2.2 The exception of implementation

The implementation exception was for the first time established by the Court in *Nakajima* during the GATT era. In that case, Nakajima, a Japanese printer manufacturer, brought an action for annulment of the regulation imposing definitive anti-dumping duties on its products and argued that the EC Basic Anti-dumping Regulation was in breach of the GATT Anti-dumping Code. The Council, on the contrary, submitted that the Anti-Dumping Code did not confer on individuals rights

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<sup>256</sup> Ibid, paras. 47- 48.

<sup>257</sup> Case C-280/93, *Germany v Council*, n.25, para.111; Case C-149/96, *Portugal v Council*, n.22, para. 49.

<sup>258</sup> Case C-149/96, *Portugal v Council*, n.22, para 49.

<sup>259</sup> Francis Snyder, n.26, p. 342.

<sup>260</sup> Regulation 2641/84 on the strengthening of the common commercial policy with regard in particular to protection against illicit commercial practices, OJ, L 252, 20/9/1984, p. 1–6.

<sup>261</sup> Regulation 3286/94 laying down Community procedures in the field of the common commercial policy in order to ensure the exercise of the Community's rights under international trade rules, in particular those established under the auspices of the World Trade Organization, OJ, L 349, 31/12/1994, p. 71–78.

and that the provisions of that Code were not directly applicable within the Community.<sup>262</sup> After excluding the issue of direct effect in that case, the Court initiated discussion on the implementation exception. It observed that the Basic Anti-dumping Regulation made explicit reference to, and was adopted in accordance with, existing international obligations, in particular those arising from Article VI of the GATT and from the Anti-Dumping Code; the Community was therefore under an obligation to ensure compliance with the GATT and its implementing measures.<sup>263</sup> As a result, the legality of the contested regulation imposing anti-dumping duties could be assessed in the light of the provisions of the Code but eventually no GATT-breach was found in the judgement.

After the entry into force of the WTO, the Court in the *Petrotub* case, confirmed the continued application of the *Nakajima* doctrine under the ADA, which replaced the GATT Anti-dumping Code.<sup>264</sup>

### **2.2.3 The exception of clear reference**

The foundational case of the clear reference exception was *Fediol*. In that case, the European Association of Seed Crushers and Oil Processors (Fediol) sought to annul a Commission decision rejecting its complaints against certain trade practices employed in Argentina, which were alleged to be in breach of GATT 1947. The contested Commission decision was made in accordance with the New Commercial Policy Instrument, which was designed to deal with the illicit commercial practice faced by European traders in third countries. An affirmative Commission decision regarding the illicit trade practice in a particular country might lead to the initiation of a claim against that country at the GATT dispute settlement. However, after the investigation, it was concluded in the contested Commission decision that there was no GATT violation in the contested practice of Argentina. Consequently, the applicant brought the complaint to the Court.

In the judgement, the Court, while confirming the lack of direct effect of GATT 1947, opined that this proposition could not prevent it from interpreting and applying

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<sup>262</sup> Case C-69/89, *Nakajima All Precision Co. Ltd v Council*, [1991] ECR I-2069, para. 27.

<sup>263</sup> *Ibid*, para. 30-31.

<sup>264</sup> Joined cases T-33/98 and T-34/98, *Petrotub SA and Republica SA v Council*, [1999] ECR II-3837.

the rules of GATT with reference to a given case, in order to establish whether certain specific commercial practices should be considered incompatible with those rules; GATT provisions have an independent meaning which, for the purposes of their application in specific cases, is to be determined by way of interpretation.<sup>265</sup> Therefore, the GATT provisions formed part of the rules of international law to which the New Commercial Policy Instrument explicitly referred; thus, even without direct effect, the applicants may still rely on the GATT provisions to obtain a ruling on whether the criticised conduct constitutes an illicit commercial practice.<sup>266</sup>

The rationale seems to be that, since the Commission made its decision on the basis of the GATT provisions, the interested party is thus entitled to request the Court to review the legality of the Commission's decision in the light of those provisions.<sup>267</sup> On the one hand, the Commission, through interpreting the relevant GATT rules, possesses the discretion to decide on whether to pursue a complaint under the GATT dispute settlement. On the other hand, however, its decision, as well as the interpretation, cannot be shielded by the lack of direct effect from the legality review in the light of the GATT rules being interpreted.

The New Commercial Policy Instrument was replaced by the Trade Barrier Regulation after the Uruguay Round, the application of the clear reference exception to which was confirmed in *FICF*.<sup>268</sup>

In sum, both the implementation and the clear reference exceptions originating from the application of GATT 1947 have been maintained and extended into the WTO context. According to the Court, as exceptions to the lack of direct effect, these rules must be interpreted restrictively. To date, their application is still limited to the circumstances where they were originally founded. It is thus argued that the Court had little difficulty in applying GATT/WTO rules when the balance of domestic powers was not at stake and when it was a matter of assessing whether foreign governments had violated their GATT/WTO obligations.<sup>269</sup> For instance, the clear reference exception is in essence not concerned with the conformity of EU legislation tested against WTO law but the legislation of another WTO Member and

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<sup>265</sup> Case 70/87, *Fediol v Commission*, [1989] ECR 1781, para. 21.

<sup>266</sup> *Ibid*, para 19.

<sup>267</sup> *Ibid*, para 22.

<sup>268</sup> Case T- 317/02, *FICF and others v Commission*, [2004] ECR II-4325.

<sup>269</sup> Thomas Cottier, n.2, p. 108.

consequently application of WTO law in these cases is not such as to have any further effects in the Community legal order.<sup>270</sup> In any event, the use of exceptions, rather than a general rule, enhances the continued power of the European Court as the gatekeeper: they enable the litigant to invoke the GATT/WTO, but ensure that the Court controls whether and how they are applied.<sup>271</sup>

#### **2.2.4 The principle of consistent interpretation**

Within the EU legal order, the principle of consistent interpretation is a requirement for both European Court and the court of Member States in the interpretation process. It not only mandates interpreting the national law of the Member States in light of Community law, it also applies where Community law is open to more than one interpretation. In the latter case, preference should be given to the one in accordance with the international agreement concluded by the EU. As the Court ruled in *Commission v. Germany*, the primacy of international agreements over provisions of secondary Community legislation means that such provisions must, insofar as is possible, be interpreted in a manner that is consistent with those agreements.<sup>272</sup>

In the GATT/WTO context, this principle is an issue distinct from direct effect. Unlike direct effect, consistent interpretation does not overrule the law being interpreted; rather, it allows, or requires, the bringing of domestic legislation into conformity as far as possible with WTO obligations.<sup>273</sup> From a practical perspective, it indeed guarantees a significant role of the GATT/WTO rules in construing the EU law and the law of the Member States.

The application of the consistent interpretation principle to GATT 1947 was first established in *Werner*, where the Court opined that Article XI GATT on elimination of quantitative restrictions could be considered to be relevant for the purposes of interpreting a Community instrument governing international trade.<sup>274</sup> A similar

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<sup>270</sup> Antonis Antoniadis, n.60, p.73.

<sup>271</sup> Francis Snyder, n.26, p. 333 - 343.

<sup>272</sup> Case C-61/94, *Commission v Germany*, n.45, para. 52.

<sup>273</sup> Thomas Cottier, n.2, p. 109.

<sup>274</sup> Case C-70/94, *Fritz Werner Industrie-Ausrüstungen GmbH v Federal Republic of Germany*, [1995] ECR I-3189, para 23.

position was later taken in *Leifer*.<sup>275</sup>

During the WTO era, the application of this principle continued. In *Hermès*, rather than answering the question of direct effect, the Court turned to the duty of the national court to interpret the procedural rules in the light of Article 50 of TRIPS Agreement.<sup>276</sup> In the subsequent *Dior* case, the Court followed the same approach and provided a more explicit statement in this regard. In particular, the Court observed “in a field to which TRIPs applies and in respect of which the Community has already legislated, the judicial authorities of the Member States are required by virtue of Community law, when called upon to apply national rules with a view to ordering provisional measures for the protection of rights falling within such a field, to do so as far as possible in the light of the wording and purpose of Article 50 of TRIPs”.<sup>277</sup> According to the Court, therefore, interpreting national legislation in the light of WTO law is a EU law obligation, which should thus be distinguished from the legal effect arising directly from the WTO. That is to say, with regard to the WTO subject matters where the Community has already legislated, it is the EU law that obliges the courts of both Member States and the Community to interpret, as far as possible, the relevant domestic rules in accordance with the WTO law.

Overall, the duty of consistent interpretation provides a satisfactory alternative to the full direct effect of WTO law.<sup>278</sup> While acknowledging that, owing to their special nature, WTO rules are not capable of being enforced in the Community legal order, their undoubted importance to the construction of Community legislation in areas of substantive legislative overlap is thereby restored.<sup>279</sup> However, the inherent limitations of this principle are also manifest: the relevant Community or national legislation must exist and be sufficiently flexible to be interpreted; there must not be manifest conflict between WTO law and the legislation to be interpreted; case-by-case interpretation cannot resolve all problems; and consistent interpretation is less effective than direct effect in establishing legal certainty and hence creating

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<sup>275</sup> Case C-83/94, *Criminal proceedings against Peter Leifer and Others*, [1995] ECR I-3231, para 24.

<sup>276</sup> Case C-53/96, *Hermès International v FHT Marketing Choice BV*, [1998] ECR I-3603, para 35.

<sup>277</sup> Joined cases C-300/98 and C-392/98, *Parfums Christian Dior SA v TUK Consultancy BV and Assco Gerüste GmbH and Rob van Dijk v Wilhelm Layher GmbH & Co. KG and Layher BV*, [2000] ECR I-11307, para 49.

<sup>278</sup> Antonis Antoniadis, n.60, p.74.

<sup>279</sup> Panos Koutrakos, *EU International Relations Law*, Oxford: Hart, 2006, p.288.

confidence among the EU's trading partners.<sup>280</sup>

### 2.2.5 Direct effect of WTO rulings

The enforcement of WTO law not only refers to the implementation of the trading rules specified in the WTO agreements, it also covers the legal effect of the so-called WTO rulings, namely the WTO panel/ Appellate Body reports adopted by the Dispute Settlement Body (DSB). Indeed, it is not a matter of construing WTO law autonomously, but of implementing a specific decision of an international organisation and thus the problem of judiciability arises in different terms.

Disputes over the direct effect of WTO rulings mainly arise in the WTO banana saga between the US, Latin American countries, and the EU. In September 1997, the DSB adopted the Appellate Body report condemning the WTO violation of the Community 1993 regime on the common organisation of the market in bananas. In order to implement the WTO ruling, the EU adopted several regulations amending the 1993 regime, which brought into force the 1999 banana regime. However, the WTO compliance of the new regime was once again challenged at the WTO and another unfavourable ruling was later delivered.<sup>281</sup>

Chiquita, one Italian banana importer, then lodged a case in the Court claiming for compensation in respect of loss allegedly suffered by reason of the 1999 regime, which was announced WTO-incompatible in the second DSB decision.<sup>282</sup> In particular, the applicant contended, by enforcing the new import regime, that the Community was intended to implement a particular obligation assumed under the first WTO ruling in 1997 and thus the *Nakajima* doctrine should apply. However, the Court held a different point of view. It first ruled that as an exception to the principle that individuals may not directly rely on WTO provisions before the Community judicature, the *Nakajima* doctrine must be interpreted restrictively.<sup>283</sup> Second, the

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<sup>280</sup> Francis Snyder, n.26, p. 364.

<sup>281</sup> It has been argued that the EC decided not to comply with this ruling because of an overriding public interest, namely the desire to protect the relative position of the ACP banana exporting countries compared to the so-called dollar-banana countries. Marco Bronckers, 'From "direct effect" to "muted dialogue": recent development in the European Courts' case law on the WTO and beyond', *Journal of International Economic Law*, (2008) 11, 885-898.

<sup>282</sup> Case T-19/01, *Chiquita Brands International Inc., Chiquita Banana Co. BV and Chiquita Italia SpA. V. Commission of the European Communities*, [2005] ECR II-315.

<sup>283</sup> *Ibid*, para. 117.

circumstances of the adoption of the 1999 regime cannot be compared with the Basic Anti-dumping Regulations to which the *Nakajima* case law applied. The new regime did not transpose into Community law rules arising from a WTO agreement for the purpose of maintaining the balance of the rights and obligations of the parties to that agreement; and thus the WTO rulings concerned did not include any special obligations which the Commission intended to implement, within the meaning of the *Nakajima* doctrine.<sup>284</sup>

Shortly after, a similar issue was raised again in *Van Parys*. The applicant, also a European banana importer, brought two actions against the decisions of the Belgian Intervention and Refund Board (BIRB), which refused to issue it with import licences for the full amounts applied for. In its actions Van Parys submitted that those decisions should be annulled because of the unlawfulness, in the light of the WTO rules, of the 1999 banana regime on which those decisions were based. In that case, the Court first re-confirmed the non-applicability of the *Nakajima* doctrine as established in *Chiquita*.<sup>285</sup> With regard to the issue of direct effect, the Court generally followed the reasoning in *Portugal v Council*.<sup>286</sup> The Court first recalled the considerable importance accorded to negotiation in the WTO dispute settlement system, which was evidently reflected in the options provided under Article 22 DSU;<sup>287</sup> it further invoked the principle of reciprocity, the lack of which would risk introducing an anomaly in the application of the WTO rules.<sup>288</sup>

At the WTO, moreover, after the EU's failure to amend the WTO-incompatible measures, the DSB authorised the US to use retaliatory actions to induce the compliance and to balance the economic disadvantage caused. These retaliatory measures damaged a group of European traders by the increased US tariff on the exports of certain products, such as batteries, bedlinen, paper boxes and other products. Consequently, the affected traders brought a number of compensation claims to the Court for the damages they had suffered.<sup>289</sup>

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<sup>284</sup> Ibid, para. 168.

<sup>285</sup> Case C-377/02, *Léon Van Parys NV v. Belgisch Interventie- en Restitutiebureau (BIRB)* [2005] ECR I-1465, para 41.

<sup>286</sup> Case C-149/96, *Portugal v Council*, n.22.

<sup>287</sup> Case C-377/02, *Léon Van Parys NV v. Belgisch Interventie- en Restitutiebureau (BIRB)*, n.108, paras 42 and 48.

<sup>288</sup> Ibid, para. 53.

<sup>289</sup> Case C-104/97 P, *Atlanta AG and others v Commission and Council*, [1999] ECR I-6983; Joined cases C-120/06 P and C-121/06 P, *FIAMM and others v Council and Commission*, [2008] ECR I-

In *FIAMM*, the Court elaborated on this issue in great detail. In general, the Court observed that the WTO rulings and the substantive WTO rules cannot be fundamentally distinguished from each other, at least for the purpose of reviewing the legality of the conduct of the Community institutions. A recommendation or a ruling of the DSB is no more capable of conferring rights upon individuals than those WTO rules, whether in annulment proceedings or an action for compensation.<sup>290</sup> The Court based this conclusion on two pillars. First of all, the general nature of the WTO agreement, especially the reciprocity and flexibility thereof, has not changed either after the ruling has been adopted or after the implementation period has elapsed.<sup>291</sup> Even after the expiry of the implementation period, the Community retains the possibility, according to the DSU, to find a mutually acceptable solution. Second, as is apparent from Article 3(2) of the DSU, recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the WTO agreements. As a result, a WTO ruling finding a WTO infringement cannot have the effect of requiring a WTO Member to accord individuals a right, which they do not have by virtue of those agreements in the absence of such a ruling.<sup>292</sup>

The essence of the Court's ruling is as follows: there is an inescapable and direct link between the WTO decision and the plea of breach of the provisions of GATT, consequently such a decision could be taken into consideration only if the Court had found the WTO rules allegedly breached to have direct effect.<sup>293</sup> In other words, the legal effect of WTO rulings is inextricably linked to the effect of the WTO rules under dispute. Owing to the conventional denial of direct effect, WTO rulings are therefore generally excluded from the rules in the light of which the legality of Community law could be assessed. It is also argued that some of the main reasons for denying the direct effect of the WTO lie in the characteristics of WTO dispute settlement; thus, not surprisingly, the Court has extended this conclusion to encompass the outcome of WTO dispute settlement processes, including panel and Appellate Body reports.<sup>294</sup>

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<sup>290</sup> Joined cases C-120/06 P and C-121/06 P, *FIAMM and others v Council and Commission*, n.112, para.120.

<sup>291</sup> *Ibid*, para. 130.

<sup>292</sup> *Ibid*, para. 131.

<sup>293</sup> Case C-104/97 P, *Atlanta AG and others v Commission and Council*, n.112, paras. 19-20.

<sup>294</sup> Francis Snyder, n.26, p.335.

However, recent case law has represented so-called “muted dialogues” between the European Court and the WTO tribunals.<sup>295</sup> Even if the European Court does not explicitly rely on the pertinent WTO ruling in interpreting the Community law, it seems a fair guess that the judgements are influenced by WTO precedents and, albeit implicitly, seek to avoid inconsistencies.<sup>296</sup> This practice has been clearly exemplified in cases such *IKEA* and *FTS International*.<sup>297</sup> In *IKEA*, the Court criticised the zeroing practice of the commission in the anti-dumping investigation against the bedlinen from Egypt, India and Pakistan and sanctioned the unlawfulness of Regulation 2398/97 imposing a definitive anti-dumping duty on imports of cotton-type bedlinen.<sup>298</sup> Even if no explicit reference was made to the earlier but same conclusion reached by the WTO Appellate Body,<sup>299</sup> it nevertheless appears that the Court’s interpretation was substantially influenced by the disapproval of the same measure by the Appellate Body.<sup>300</sup> This influence became even more manifest in *FTS International*, where the Court delivered an interpretation of the Community tariff classification of boneless chicken cuts and overruled the traditional interpretation given by the custom authorities. In fact, such interpretation was also condemned at the WTO.<sup>301</sup> It is thus argued that by transforming WTO rulings into interpretations of the Community law, the European Court keeps hands free to deviate from these WTO rulings if and when the need to do so arises, while avoiding inconsistencies as much as possible.<sup>302</sup>

### **2.3 Summary remarks**

The relationship between WTO law and domestic law is a controversial topic because it goes to the heart of fundamental constitutional questions, at both the domestic and international levels. It is mainly due to the involvement of competing interests: effectiveness of international law and WTO law on the one hand, balanced

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<sup>295</sup> Marco Bronckers, n.104.

<sup>296</sup> *Ibid.*, p.887.

<sup>297</sup> Case C-310/06, *F.T.S. International BV v Belastingdienst*, [2007] ECR I-6749; Case C-351/04, *Ikea Wholesale Ltd v Commissioners of Customs & Excise*, [2007] ECR I-7723.

<sup>298</sup> Case C-351/04, *Ikea Wholesale Ltd v Commissioners of Customs & Excise*, n.120, paras. 55-57.

<sup>299</sup> *EC — Bed Linen*, Appellate Body Report, WT/DS141/AB/R.

<sup>300</sup> Marco Bronckers, n.104, p.889.

<sup>301</sup> *EC — Chicken Cuts*, Panel Report and Appellate Body Report, WT/DS269/R, WT/DS269/AB/R, WT/DS286/R, WT/DS286/AB/R.

<sup>302</sup> Marco Bronckers, n.104, p.890.

international legal relations and domestic balance of powers on the other hand. The doctrine of direct effect and judicial implementation of WTO rules thus have to be considered in a broader than purely legal and technical manner.<sup>303</sup>

Against the general background of the EU's reception of international law, as the *Intertanko* judgment demonstrated, the WTO is no longer the only international agreement the direct effect of which has been declined by the European Court. Hence, rather than an exception to the existing jurisprudence confirming judicial enforceability of most international agreements, it might be better to consider the WTO as a starting point of the track through which the Court wishes to develop and establish the outer limits on its previous liberal approaches in this regard. Furthermore, it is also important to note that there are nonetheless different and sometimes rather subtle ways for the European Court to grant domestic law effect to a treaty; direct effect is but just one of the options.<sup>304</sup>

Based on the preceding discussion on the CCP and EU-WTO interaction, the EU legislation implementing the transitional trade mechanisms has to be primarily formulated in accordance with the multilateral rules agreed at the WTO. Direct effect of these rules has been generally excluded; however, insofar as anti-dumping is concerned, it is still interesting to see whether the European Court is inclined to extend the application of the *Nakajima* principle and to assess the legality of the Community legislation directly in the light of the transitional anti-dumping regime.<sup>305</sup> Furthermore, due to the textual brevity and policy flexibility under such mechanisms, as analysed in the T&C sector and to be further explored later under China's WTO membership, the EU implementing legislation in this regard involves, or depends on, more frequent use of the autonomous discretion in comparison with WTO disciplines in other areas.

### ***Section III. The bilateral textile agreements of the EC***

During the GATT era, the MFA was the major world-wide discipline in the trade of textiles; and Article 4 thereof provided the chance for the contracting parties to

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<sup>303</sup> Thomas Cottier, n.2, p. 112.

<sup>304</sup> Marco Bronckers, n.104, p.897.

<sup>305</sup> Although not included in the T&C sector, the transitional anti-dumping mechanism is introduced under China's WTO membership. For detailed discussion, see Chapter III Section I.

negotiate and conclude bilateral agreements.<sup>306</sup> Consequently, from the beginning of the MFA in 1974, the EC proposed the opening of negotiations for bilateral agreements with seventeen exporting countries and twelve agreements were concluded or, at least, initiated in June 1976. In the course of negotiations, the principal aims included: to obtain adequate guarantee against the effective risk of market disruption; the progressive and well-ordered liberalisation of trade; and to seek a better balance inside the EC.<sup>307</sup>

The bilateral textile agreements concluded by the EC were expected, at least by the drafter, to contribute to putting the import potential of each Member State onto a more definite basis and to help create a common market in textile products.<sup>308</sup> Moreover, the agreements also aimed at gradually abolishing obstacles to the textile trade and leading to greater liberalisation of world trade in this sector, while at the same time steering clear of the risk of disorganisation in the EC markets.<sup>309</sup>

Products covered in these agreements, subject to different import policies, were arranged into several annexes.<sup>310</sup> In essence, the agreements negotiated were based on the VERs provided by the supplier countries. The EC came to an agreement with the third country including a number of annual quantitative restrictions on the sensitive textile products, which risked market disruption and were thus incorporated into one annex.<sup>311</sup> Within the Community, these quantitative restrictions were enforced through a sub-division system. This system divided the global quotas into various national shares among the Member States.<sup>312</sup> Meanwhile, other products, falling within the scope of the agreement but not subject to the annual restrictions described above, were usually listed together in another annex. Although free from

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<sup>306</sup> In particular, Article 4 MFA provided that “participating countries may, consistently with the basic objectives and principles of this arrangement, conclude bilateral agreements on mutually acceptable terms in order, on the one hand, to eliminate real risks of market disruption (as defined in Annex A) in importing countries and disruption to the textile trade of exporting countries, and on the other hand to ensure the expansion and orderly development of trade in textiles and the equitable treatment of participating countries”. Detailed discussion in this regard is provided in Chapter I Section 1.3.

<sup>307</sup> Commission of the European Communities, Directorate General of Information, ‘European Community textile agreements under the international arrangement for trade in textiles’, Information Paper 131/76, Brussels 1976, p.4

<sup>308</sup> Ibid.

<sup>309</sup> Ibid, p.10

<sup>310</sup> The number and content of annexes vary from one to another depending on different agreements; however, the general classification was very similar, if not identical.

<sup>311</sup> 1988 Agreement between the EEC and China on trade in textile products, OJ, L 380, 31/12/1988, p. 2-73; 1988 Agreement between the EEC and Hong Kong on trade in textile products, OJ, L 97, 14/04/1988, p. 2-40.

<sup>312</sup> For detailed discussion, see Section 3.2.

annual import quotas, these products were managed by the EC textile safeguard system, namely, the basket mechanism, established in the agreements.

The following discussion will focus on several important instruments under the MFA bilateral agreements of the EC, including the basket mechanism, the sub-division of the global quotas and other relevant mechanisms.<sup>313</sup>

### **3.1 The EC textile safeguards: the basket mechanism**

The bilateral textile agreements generally excluded the application of safeguard measures under both GATT 1947 and the MFA. It was provided that the EC undertook to suspend the application of quantitative restrictions currently in force and not to introduce new ones through either Article XIX of the GATT or Article 3 of the MFA.<sup>314</sup> This exclusion was considered as the compensation, or a reward, for the VERs promised by the supplier countries. The question then arises as to whether textile imports from such countries were indeed free from unilateral safeguard actions. This question deserves a negative answer in that another specific safeguard instrument was introduced under the bilateral agreements, namely, the basket mechanism, which was also addressed as the system of administrative control.<sup>315</sup>

The basket mechanism set out detailed threshold levels for different product categories not subject to the annual quotas. In most cases, these textile products were free from quantitative restrictions; however, once the threshold levels stipulated were exceeded, the EC might request the opening of consultations with the exporting country. Pending a mutually satisfactory solution from the consultations, the exporting country undertook to limit the exports concerned to an agreed level for a provisional period starting from the date upon which the request for consultations was made.<sup>316</sup> In the case that the parties were unable to agree on any satisfactory solution within a certain period, the EC would have the right to introduce a definitive

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<sup>313</sup> The Commission, while negotiating those bilateral agreements, tried to establish a set of standard provisions on the basis of the MFA text. Despite the existence of disparities, certain provisions are common to all the agreements.

<sup>314</sup> Articles 2 and 3, 1988 Agreement between the EEC and China, n.134.

<sup>315</sup> Article 6, 1988 Agreement between the EEC and China, n.134; Article 7, 1988 Agreement between the EEC and Hong Kong, n.134.

<sup>316</sup> Article 6, 1988 Agreement between the EEC and China, n.134.

quantitative limit at an annual level.<sup>317</sup>

It is thus argued that the rationale underlying the basket mechanism is that if the cup is full, one more drop can cause it to overflow. Consequently, excess imports had to be stabilised through the imposition of quantitative restrictions, irrespective of the price, quantity of imports and the conditions for market disruption mentioned in Annex A to the MFA.<sup>318</sup> In contrast, for any quantitative restriction under Article 3 MFA, competent authorities of the importing country had to investigate and eventually prove the existence of all the elements mentioned above.<sup>319</sup>

However, the MFA compliance of this mechanism is highly controversial. According to Article 4(3) MFA, bilateral agreements maintained under this article would, on overall terms, including base levels and growth rates, be more liberal than measures provided for in Article 3 of this arrangement.<sup>320</sup> It is therefore rather questionable whether the basket mechanism managed to fulfil this criterion for a liberalised trade policy. To impose a quantitative restriction under such a mechanism, the EC merely needed to prove the existence of excess imports compared with the quantified threshold levels. In contrast, Article 3 MFA required an investigation process to prove the stipulated pre-conditions for action, especially the existence of market disruption consisting of several economic elements.<sup>321</sup> The latter therefore appeared to have imposed more obligations, or restrictions, upon the importing country and guaranteed the supplier country a comparatively favourable position. Unless the threshold levels had been set up with considerably sizable quantities—this apparently was not the case under the textile agreements—the basket mechanism would otherwise suggest a regime with a more trade-restrictive effect. As mentioned in the previous chapter, dependence on the bilateral approach, which was usually combined with deviations from the multilateral system and more restrictive trade policies, considerably jeopardised the entire liberalisation process under the MFA.

### **3.2 Sub-division of Community quotas**

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<sup>317</sup> Ibid.

<sup>318</sup> Article 41 VCLT. Niels Blokker, *International Regulation of World Trade in Textiles: Lessons for Practice a Contribution to Theory*, Martinus Nijhoff Publishers, 1989.

<sup>319</sup> For detailed discussions on the MFA safeguards, see Chapter I Section 1.2.

<sup>320</sup> Article 4 (3) MFA.

<sup>321</sup> For detailed discussions, see Chapter I Section 1.2.

The Community import quotas agreed upon in the bilateral agreements and the threshold levels established in the basket mechanism were sub-divided into shares of individual Member States. Products subject to annual quantitative restrictions could be imported into a Member State only if its sub-quota had not been filled; and similarly, not only did the imposition of safeguards become possible once the overall ceiling under the basket mechanism was reached, but also if one Member State's share of this ceiling was attained.<sup>322</sup>

According to the EC, this sub-division system was adopted in order to facilitate the full utilisation of Community quotas, to secure a better distribution of the quantities imported among the different regions and to meet the diverse requirements among Member States.<sup>323</sup> It further explained that the extent of the disparities existing in the conditions for importation of these products into the Member States and the particularly sensitive position of the Community textile industry meant that the said conditions could be standardised only gradually and the allocation of supplies could not immediately be affected on the basis of requirements alone.<sup>324</sup> Therefore, any quantitative limit shall be allocated in such a way as to ensure the improved utilisation of these quantitative limits and to attain progressively a more balanced penetration of the markets by means of improved burden-sharing between the Member States.<sup>325</sup> However, it is argued that the burden-sharing key, which was more than a genuine sharing of the burden of imports, reflected the level of protection which individual Member States wanted to maintain.<sup>326</sup>

In practice, when the demand arose for protecting ailing textile industries against imports, the EC first assessed the overall capacities for market absorption for various groups within the industry and then decided the level of global ceilings to that effect. Second, these ceilings were divided over the MFA countries, as well as the countries enjoying preferential treatment. However, once Community quotas were introduced either in the context of the MFA or by virtue of one of the common import regulations, these quotas were not open for imports anywhere in the Community by any importer until they were subdivided into national sub-quotas.<sup>327</sup>

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<sup>322</sup> Council Regulation 2135/89 on common rules for imports of certain textile products originating in the People's Republic of China, OJ, L 212, 22/07/1989 p.1 – 78.

<sup>323</sup> Ibid.

<sup>324</sup> Ibid.

<sup>325</sup> Ibid.

<sup>326</sup> Piet Eeckhout, n.36, p. 189.

<sup>327</sup> E.L.M. Völker, *Protectionism and the European Community: Import Relief Measures Taken by the*

### 3.2.1 Policy evolution towards uniformity

The textile quotas were divided with the aim of improved utilisation and balanced penetration of the markets, rather than in a way requiring apportioning them evenly among the Member States. Inevitably, the consequent national shares varied from one another and differentiated conditions of importation thus emerged in the internal market. As mentioned earlier, the existence of quota sub-division, to a certain extent, exemplified the non-uniformity of the CCP, at least in the sector of T&C.

With a view to completing the internal market as well as to achieving policy uniformity, from 1987 onwards, the sub-division operation of quotas started being gradually released through a system called “inter-regional transfers”. This system provided the chance for a supplying country, after June 1 of each year, to transfer the unused quantities from the quota-share of one Member State to that of another, without permission from the Commission.<sup>328</sup> In 1992 – 1993, sub-division of the T&C quotas eventually terminated as a result of the reform in the internal market; from then on, quantitative restrictions of the EC are no longer broken down into Member States' shares.

As the Court pointed out, the extent of the disparities existing in the conditions for importation of these products and the particularly sensitive position of the Community textiles industry meant that uniform conditions could be standardised only gradually. It was mainly because a number of products were considered to be too sensitive in terms of the effect their importation would have on domestic production.<sup>329</sup> Consequently, the sub-division system of Community quotas turned out to be a provisional but essential passage towards policy uniformity required by the CCP.

### 3.2.2 The intra-Community safeguards under Article 134 EC

Article 134 EC provides that “in order to ensure that the execution of measures of

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*European Economic Community and the Member States, and the Legal Remedies Available to Private Parties*, Kluwer Law and Taxation Publishers, 1987, p.166.

<sup>328</sup> Piet Eeckhout, n.36, p. 195.

<sup>329</sup> Panos Koutrakos, n.45, p. 251.

commercial policy taken in accordance with this Treaty by any Member State is not obstructed by deflection of trade, or where differences between such measures lead to economic difficulties in one or more Member States, the Commission shall recommend the methods for the requisite cooperation between Member States. Failing this, the Commission may authorise Member States to take the necessary protective measures, the conditions and details of which it shall determine...in the selection of such measures, priority shall be given to those which cause the least disturbance of the functioning of the common market”.

In contrast with the import restriction set up at the EC customs border against direct imports from the third countries, Article 134 establishes a device of internal control of the indirect imports from one Member State.<sup>330</sup> A Member State, after having obtained the authorisation from the Commission, is entitled to protect its national market against goods from another Member State which are originally imported from a third country. On the one hand, restriction under this Article is enacted by individual Member State, rather than by the Community institution. On the other hand, such restriction could come into force only after special authorisation from the Commission. As the Court ruled in *Tezi*, “Article 115 EEC (Article 134 EC) not only constituted an exception to the fundamental provisions on free movements of goods under Articles 9 and 30 of the Treaty, it also formed an obstacle to the implementation of the CCP under Article 113 EEC. Consequently, it must be interpreted and applied strictly”.<sup>331</sup>

As a result of the different importation conditions amongst the Member States, typically in the form of varying national quota shares, the possibility of quota circumvention or evasion unavoidably emerged. If a Community importer would like to import certain textile products into a particular Member State with a restrictive import regime, he would probably choose to first import the products into the internal market through another Member State, which was operating a comparatively liberal import policy, and then transfer them to their the eventual destination through the borderless circulation within the EU. It is at the juncture that Article 134 came

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<sup>330</sup> Direct imports embrace all goods of non-Community origin sought to be imported into a Member State without first passing the border of another Member State; indirect imports embrace all goods of non-Community origin that are sought to be imported into one Member State by way of another Member State into which they have been imported first. Hu Yuanxiang, *Legal and Policy Issues of the Trade and Economic Relations between China and the EEC: A Comparative Study*, Kluwer Law and Taxation Publishers, 1991, Chapter VI.

<sup>331</sup> Case 59/84, *Tezi Textiel BV v Commission*, n.42.

into play to prevent the circumvented indirect imports. Obviously, there would be no need for such a measure if a unified import policy prevailed throughout the internal market, where the potential importation would be treated in the identical manner throughout the territory of the Community. In other words, the intra-Community safeguard mechanism was, to a certain extent, the inevitable corollary of the subdivision system. Therefore, the lifting of the uneven quota allocations and the subdivision system in 1992 -1993 considerably deprived the Article 134 safeguards of their significance.

### **3.3 Other provisions**

The EC textile agreements also featured the following elements. First, the exportation and importation of products under quantitative restrictions were monitored by a double-checking system.<sup>332</sup> In practice, this meant that the use of quantitative restrictions was controlled by the authorities of both the exporting and the importing countries. The former undertook to issue export documents or certificates in respect of all consignments up to the annual quantitative limits or any other quotas under the agreement. Meanwhile, the competent Community or Member States authorities granted such import authorisation subject to the presentation of the corresponding export license.

Second, the annual quantitative restrictions were not unchangeable. At the beginning of the agreements, fixed annual growth rate was set up as a minimum of six per cent compared with the preceding 12-month period. In certain exceptional situations,<sup>333</sup> a lower positive growth rate could be decided.<sup>334</sup> However, it was changed in 1986 when the contracting parties decided to extend the MFA for the third time. Since then, lower figures could be mutually agreed upon between exporting and importing participants.<sup>335</sup> In fact, most growth rates specified in the later bilateral agreements were much lower than six per cent as prescribed earlier in the MFA.

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<sup>332</sup> Title III, Protocol A, the 1988 textile agreement between the EEC and China; Title III, Protocol A, the 1988 Agreement between the EEC and Hong Kong, n. 134.

<sup>333</sup> According to the MFA, these exceptional situations referred to where there are clear grounds for holding that the market disruption will recur or be exacerbated if the growth rate is implemented, and where the implementation of the above growth rate would cause damage to those countries' minimum viable production.

<sup>334</sup> Annex B, the MFA.

<sup>335</sup> Protocol extending the Arrangement regarding international trade in textiles, OJ, L341, 04/12/1986, p.34-38.

Third, the flexible application of quotas was also reflected in the agreement provisions on inter-regional transfer and cross-product/year transfer. In the former case, portions of the quantitative limits not used in one region of the Community could be allocated to another region in order to achieve the most efficient utilisation.<sup>336</sup> As to the latter, transfers could be made between either quotas of certain product categories or between quotas of different years<sup>337</sup>, which corresponded to the approaches of inter-group transfer, carry-over and carry forward.<sup>338</sup> Furthermore, in order to ensure that the quota adjustment would not result in market disruption or disruption of traditional trade flows, a particular clause on anti-concentration was established, according to which the importing countries undertook to endeavour to ensure that their textile exports would be spaced out as evenly as possible over the year.<sup>339</sup>

Last but not least, the consultation procedure constituted an indispensable element in the agreement enforcement. The potential risks of market disruption, or any other problems, should, in the first place, seek to be resolved through this procedure,<sup>340</sup> which was intended to provide a forum of negotiation for the contracting parties. In most cases, neither party was allowed to, or had to, adopt the action with trade-restrictive effect unless it was agreed bilaterally. However, unilateral action was still available under certain circumstances, i.e. the basket mechanism, where the aim of import control could be easily achieved by means of either VER taken by the exporting country, or unilateral restriction imposed by the Community at the end of the negotiations.<sup>341</sup>

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<sup>336</sup> Article 10, the 1988 textile agreement between the EEC and China; Article 12, the 1988 Agreement between the EEC and Hong Kong, n. 134.

<sup>337</sup> Article 5, the 1988 textile agreement between the EEC and China; Article 6, the 1988 Agreement between the EEC and Hong Kong, n. 134.

<sup>338</sup> Inter-group transfer is an adjustment between the restraint levels for different products during a particular year. In the situation where the level of exports of a product is likely to exceed the restraint level in a particular year, a provision of carry-forward will allow for borrowing from the quota of the same product in the next year. Similarly, when the restraint level of a product in a particular year is not fully utilised by the actual export level of that product there is a provision for utilisation of the unused level in the next year and it is called carry-over.

<sup>339</sup> Article 8, the 1988 textile agreement between the EEC and China; Article 11, the 1988 Agreement between the EEC and Hong Kong, n. 134.

<sup>340</sup> Articles 6, 7, 8, 10, 13, 15 and 18, the 1988 Agreement between the EEC and China, n. 134.

<sup>341</sup> *Ibid.*

### **3.4 Summary remarks**

The coexistence of the MFA and a number of bilateral agreements illustrates a complicated picture of the contractual CCP commitments undertaken by the EC in the textile sector. The adverse influence of the bilateral agreements is hard to overestimate. For the products imported, the agreements successfully saved the quantitative restrictions in the form of VERs imposed upon the sensitive items. For the categories not subject to VERs, a special safeguard mechanism was established under the agreements, replacing the MFA safeguards and enforcing tightened control over such imports. Furthermore, quota sub-division resulted in differential national shares and diverse import regimes among the Member States, which substantially deflected the uniformity of the CCP and the construction of the internal market. The above criticism points to the observation that, as the conventional CCP instruments at the international plane, the EC bilateral agreements diverted the policy targets of the MFA and considerably diluted the sectoral reform envisaged thereunder. Therefore, during the MFA decades, the achievement of the liberalisation progress in EC textile sector appeared minor.

### ***Section IV. Autonomous CCP instruments in T&C***

Autonomous CCP instruments mainly take the form of secondary legislation and were enacted with the aim of implementing the commitments arising out of the bilateral and multilateral agreements concluded by the EC. The T&C sector witnessed two rounds of reform in the import regime. The first one started in the early 1990s based on the demand for the completion of the internal market; and shortly after, the second round initiated in 1995 as a result of the entry into force of the WTO. The following analysis will look into the original T&C system in the 1970s, the modified mechanism after the 1990s reform and the current regime following the WTO restructuring during 1995 – 2005.

Generally speaking, prior to the 1990s reform, two groups of Community rules applied simultaneously to the T&C imports. The first group, located at the top of the application list, was the Council regulations under the title of “common rules for imports of certain textile products originating in third countries”. These regulations

were adopted with the principal aim of implementing the MFA and the bilateral textile agreements. Examples in this regard include Regulation 3059/78 and its successor Regulation 3589/82.<sup>342</sup>

The secondary group referred to the general Community rules of imports, including not only T&C products but also products from other sectors, not only imports from industrial countries but also from the so-called state-trading countries. Council regulations in this group consisted of Regulation 288/82 on common rules for imports, Regulation 1765/82 on common rules for imports from state-trading countries, Regulation 1766/82 on common rules for imports from China and Regulation 3420/83 on import arrangements for products originating in state-trading countries. Under these regulations, certain provisions were stipulated with particular attention to T&C products.

Indeed, there was an application hierarchy between these two groups of rules. In particular, where overlap and conflict took place, the priority shall always be given to the rules specifically designated for T&C products. Therefore, it is only where the T&C products concerned have not been covered by the legislation in the first group, i.e. products not covered by bilateral agreements, protocols or other arrangements, that the relevant provision from the secondary group could take over.

#### **4.1 The original EC regime in T&C**

In the 1970s, T&C products imported from all third countries were generally divided into three groups under the EC regime. With regard to Group I, the EC operated a system by which the so-called global ceilings were fixed for the overall imports. These ceilings were fixed for the eight most sensitive products, including cotton yarns, cotton fabrics, fabrics of synthetic fibres, T-shirts, pullovers, trousers and ladies' and men's shirts.<sup>343</sup> Products other than those in Group I were divided into Groups II and III, depending on different degrees of sensitivity. No global ceilings were set for these Groups; instead, the EC established the indicative maximum

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<sup>342</sup> Council Regulation 3059/78 on common rules for imports of certain textile products originating in third countries, OJ, L 365, 27/12/1978 p. 1; Council Regulation 3589/82 on common rules for imports of certain textile products originating in third countries OJ, L374, 31/12/1982 p. 106 – 309.

<sup>343</sup> E.L.M. Völker, n.150, p. 265.

growth rates for these products<sup>344</sup> corresponding to the threshold levels of basket mechanism under the bilateral agreements.

Regulation 3059/78 and its successor Regulation 3589/82 constituted the major legislation governing the T&C imports. In particular, they set forth levels for import quotas, procedures for applying the basket mechanism, rules for the prevention of fraud, treatment of flexibility requests from third countries and the criteria for quota division among Member States.<sup>345</sup> Most of these provisions could find their origin in the MFA and the bilateral textile agreements except for several provisions based on the EC's own initiative. For example, Article 14 of Regulation 3589/82 explained in detail the procedure, which should be followed by the Commission during the consultation with third countries. Article 15 further laid down rules regarding the decision-making process among different Community institutions.

#### **4.2 The completion programme of the internal market and reform in the import regime**

The completion of the internal market constituted the most important project since the foundation of the EC. Prior to the project, much progress had been made and many policies in economic integration had been adopted. However, not all the developments, as originally envisaged in the EC Treaty, indeed took place; and in 1985, the Commission seized the opportunity to launch its proposals for the completion of the internal market. In its White Paper "Completing the Internal Market", the Commission put forward to the Council a programme of legislation reform.<sup>346</sup> With the primary objective of welding together the individual markets of the Member States into one single market, measures proposed in the White Paper were classified under three headings: the removal of physical barriers, the removal of technical barriers and the removal of fiscal barriers.<sup>347</sup> Furthermore, the aim of establishing and completing a single market by 1992 was officially set in the Single European Act.<sup>348</sup> In particular, legislative measures were to be adopted with the aim

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<sup>344</sup> In setting the average growth rates, consideration was given to the fact that the Commission is negotiating lower growth rates with dominant suppliers. Furthermore, the flexibility allowed for these countries will have to be limited. E.L.M. Völker, n. 150, p.135.

<sup>345</sup> Council Regulations 3059/78 and 3589/82, n.165; E.L.M. Völker, n. 150, p. 139.

<sup>346</sup> 'Completing the internal market: white paper from the Commission to the European Council', COM(85) 310, June 1985.

<sup>347</sup> Ibid.

<sup>348</sup> Single European Act, OJ, L169, 29/6/1987, p.1-6, Subsection I. Also see Article 14 EC Treaty.

of establishing throughout the Community by December 31, 1992, an area without internal frontiers in which the free movements of goods, services, persons and capital shall be ensured.<sup>349</sup>

The Commission's new approach in harmonisation deserves further elaboration. The gist of the new approach was as follows: with regard to the areas under mandatory requirements, conflicting national rules would be invalid; for remaining areas, mutual recognition would be respected among the Member States.<sup>350</sup> Legislation harmonisation was thus restricted to the scope of laying down health and safety standards; and finally there would be promotion of European standardisation.<sup>351</sup> It therefore becomes clear that the general thrust of the completion programme was to move from the concept of total harmonisation towards that of mutual recognition and minimum harmonisation.<sup>352</sup> The former entailed exhaustive and comprehensive regulation of a given field, the corollary being the pre-emption of national action in the same area. In contrast, the latter enabled Member States to maintain more stringent regulatory standards than those prescribed by the Community, provided that these were compatible with the EC Treaty.

The concept of mutual recognition was defined in the *Cassis de Dijon* case: Member States must respect the trade rules of other Member States and not seek to impose their own rules on goods lawfully marketed in another Member State.<sup>353</sup> According to this principle, most trade barriers would be abolished except those based on the mandatory grounds included in the Treaty, i.e. public health and fiscal supervision. It was only in these situations that it became necessary for the Community to carry out legislative harmonisation in order to remove the problems of policy divergence;<sup>354</sup> and the Community approach would merely take the form of minimum standards. Indeed, the model of minimum harmonisation leaves it to the Member States to establish specific criteria above the baseline: the Community legislation would set a floor, and the Treaty a ceiling, with Member States being free to pursue their own

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<sup>349</sup> Ibid.

<sup>350</sup> Case 120/78, *Rewe-Zentrade AG v. Bundesmonopolverwaltung für Branntwein*, [1979] ECR 649. This judgement therefore encapsulated a principle of mutual recognition: MS must respect the trade rules of other states and not seek to impose their own rules on goods lawfully marketed in another Member State.

<sup>351</sup> Craig and De Burca, *EU Law: Text, Cases, and Materials*, Oxford University Press, 2003, p.1190.

<sup>352</sup> Catherine Barnard and Joanne Scott, n.47, p.359.

<sup>353</sup> Case 120/78, *Rewe-Zentrade AG v. Bundesmonopolverwaltung für Branntwein*, n. 173.

<sup>354</sup> Catherine Barnard and Joanne Scott, n.47, p.359.

policies within these boundaries.<sup>355</sup> In sum, this new approach tolerates not only the existence of independent national laws but also the discrepancy among them. This shift in approach signals a trend that the recourse to flexible techniques which leave considerable scope for regulatory choices to Member States.<sup>356</sup>

The completion programme was coupled with the reform in import regime. In T&C, the structural reform began in the second half of 1992, with a Communication issued by the Commission to the Council assessing the implications of the internal market for the commercial policy in this sector.<sup>357</sup> The Communication suggested measures needed to complete a uniform import regime required by the CCP. In response, the Council issued a resolution on the T&C industries, which recognised and agreed with the main points in the Communication and thus called upon the Commission to adopt and to propose the measures essential for sectoral development.<sup>358</sup> Subsequently, the Commission submitted the proposal for a new Council Regulation on common rules for imports of textile products.<sup>359</sup>

In 1993-1994, two Council Regulations were adopted in order to complete the reform in T&C. On October 12, 1993, the Council first enacted Regulation 3030/93 on common rules for imports of certain textile products from third countries.<sup>360</sup> This Regulation formed the primary part of the renewed system and was mainly aimed at implementing the extended MFA and the existing bilateral textile agreements. In the following year, the Council further adopted Regulation 517/94 on common rules for imports of textile products from certain third countries not covered by bilateral agreements, protocols or other arrangements, or by other specific Community import rules. This Regulation intended to integrate together the instruments, described in the previous part as the secondary group of the EC T&C rules, i.e. Regulations 288/82, 1765/82, 1766/82 and 3420/83<sup>361</sup>, as far as their application to textile products is

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<sup>355</sup> Ibid, p.25.

<sup>356</sup> Panos Koutrakos, n.45, p. 263.

<sup>357</sup> 'Implications of the internal market for commercial policy in the textile and the clothing sectors', SEC (92) 896, 27 May 1992.

<sup>358</sup> Council Resolution on the textile and clothing industries, OJ, C 178, 15/07/1992 p.3 – 5.

<sup>359</sup> Proposal for Council Regulation on common rules for imports of textile products from certain third countries initially covered by Council Regulation 288/82, 1765/82, 1766/82 and 3420/83, /\* COM/92/455FINAL \*/.

<sup>360</sup> Council Regulation 3030/93 on common rules for imports of certain textile products from third countries, OJ, L 275, 08/11/1993 p. 1 – 106.

<sup>361</sup> Council Regulation 288/82 on common rules for imports, OJ, L 35, 9/2/1982, p. 1–44; Council Regulation 1765/82 on common rules for imports from State-trading countries, OJ, L 195, 5/7/1982, p. 1–20; Council Regulation 1766/82 on common rules for imports from the People's Republic of China, OJ, L 195, 5/7/1982, p. 21–40; Council Regulation 3420/83 on import arrangements for

concerned.<sup>362</sup>

Several policy modifications were introduced in these two Regulations. First, national exceptions and derogations of the Community T&C regime were brought to an end. Quantitative restrictions enforced domestically by the Member States, as well as those maintained under the secondary group of the T&C trading rules, were either lifted or replaced by harmonised Community restrictions. For example, Regulation 288/82 on common rules for imports and Regulation 3420/83 regarding import arrangements for state-trading countries respectively laid down the national T&C quotas. During the course of reform, strong demand arose from the Commission requesting the abolition of such restrictions. Consequently, all the national quotas under Regulation 288/82 were lifted; and with regard to imports from state-trading countries, restrictions were maintained but could be imposed only at the Community level.<sup>363</sup> Therefore, under the renewed regime, there were no longer any restrictions at the discretion of the Member States.

In the second place, the Community T&C quotas were no longer broken down into Member States' shares and the practice of quota subdivision was abolished in this reform. Since then, authorities of Member States could issue import authorisations only upon the confirmation by the Commission that there were still quantities available of the total Community quotas. For the purpose of implementation, Regulation 3030/93 and Regulation 517/94 set up particular rules for administration in this regard. Under this new system, the quantitative restrictions should be allocated on the 'first come, first served' basis; as far as possible, the Commission shall confirm to the authorities the full amount indicated in the requests notified.<sup>364</sup>

The third point concerned the amended safeguard and surveillance system in the new regime. The basket mechanism under the bilateral agreements was enforced through Regulation 3030/93;<sup>365</sup> and a separate mechanism was established in Regulation 517/94, which was adopted outside the scale of the agreements mentioned. Insofar as the substantive criteria are concerned, the safeguard mechanism under Regulation

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products originating in State-trading countries, OJ, L 346, 8/12/1983, p. 6–90.

<sup>362</sup> Council Regulation 517/94 on common rules for imports of textile products from certain third countries not covered by bilateral agreements, protocols or other arrangements, or by other specific Community import rules, OJ, L067, 10/03/1994 p.1 – 75.

<sup>363</sup> Piet Eeckhout, n. 36, p. 196.

<sup>364</sup> Article 12, Council Regulation 3030/93, n. 183.

<sup>365</sup> For detailed discussion on the basket mechanism, see Section 3.1.

517/94 was rather GATT-based than MFA-based in that it employed rules fairly similar to those under Article XIX GATT. Instead of highlighting the potential risk of market disruption, as required under Article 3 MFA, Regulation 517/94 mainly focused on the serious injury and actual threat thereof to the domestic production.

Furthermore, the EU has combined surveillance and safeguards together as measures dealing with economic emergency situations. Although the SGA does not make clear reference to surveillance measures, the EU nonetheless regards it as part of the safeguard system under its own discretion. As a result, safeguards enforced by the EU have been, in most cases, accompanied by surveillance measures, which could be taken either in advance as *a priori* surveillance or retrospectively as *a posteriori*.<sup>366</sup>

#### **4.3 The EU T&C regime after the Uruguay Round**

After the entry into force of the WTO, T&C supplier countries were categorised into three groups under the EU import regime, which include WTO Members, third countries not WTO Members but contractual partners under bilateral agreements, and supplier countries neither WTO Members nor contracting partners of the EU. According to this category, different policies applied depending on the origin of the imports.

As regards WTO Members, the ATC constituted the major multilateral regime. As analysed in the preceding chapter, the progress of the integration programme would decide the applicable rules at the WTO.<sup>367</sup> Accordingly, under the EU implementation, the un-integrated T&C products were subject to the governance of Regulation 3030/93, as amended by Regulation 3289/94; and Regulation 3285/94 on the general imports rules regulated those that had integrated into the GATT.<sup>368</sup> In other words, once the integration was completed, the T&C products would be treated in the same way as imports from other sectors.

For supplier countries possessing contractual links with the EU, T&C imports were

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<sup>366</sup> Jan Hoogmartens, *EC trade law following China's accession to the WTO*, The Hague: Kluwer Law International, c2004 p.103. Article 13 Council Regulation 3030/93, n. 183; Article 11 Council Regulation 517/94, n. 185.

<sup>367</sup> For detailed discussion, see Chapter I Section II.

<sup>368</sup> Council Regulation 3285/94 on the common rules for imports and repealing Regulation 518/94, OJ, L 349, 31/12/1994, p. 53–70.

governed by the combination of Regulations 3030/93 and 517/94. The former was the principal implementation instrument of the bilateral agreements and the latter worked as a complementary device. In fact, this combined regime was not much affected by the entry into force of the ATC but for a few amendments of minor significance. A similar situation arose with the third group of supplier countries. In particular, T&C products from countries, which are neither WTO Members nor EU's contracting partners, were exclusively regulated under Regulation 517/94 and the Uruguay Round did not cause any change in this regard.<sup>369</sup> Instead of providing an overall assessment of the T&C policy, this section will primarily focus on the EU regime pertaining to the WTO Members in this sector to demonstrate the influence of multilateral policy adjustments on domestic trade policy.

Shortly after the entry into force of the ATC, the Council, in December 1994, enforced Regulation 3289/94 amending Regulation 3030/93 on common rules for imports of certain textile products from third countries.<sup>370</sup> According to the preamble, Regulation 3289/94 was adopted for the purposes of the following issues: scope enlargement of Regulation 3030/93; implementation of the ATC integration; amendment of the EU quantitative restrictions under the ATC acceleration programme; and enforcement of the ATC transitional safeguards.<sup>371</sup> In a nutshell, the primary target of Regulation 3289/94 is to add an extension part to Regulation 3030/93 in order to establish an appropriate implementing device for the ATC. Meanwhile, with regard to the existing mechanism under Regulation 3030/93 prior to the Uruguay Round, not too many changes, if any, took place.

The major amendments introduced in the new regime are as follows. First of all, the product coverage of Regulation 3030/93 was extended to include not only T&C imports originating in third countries with which the Community had concluded bilateral agreements, it also regulated those from WTO Members that had not been integrated into the GATT under the ATC integration programme.<sup>372</sup> Hence, insofar as the WTO suppliers were concerned, Regulation 3030/93 as amended was devised to regulate the un-integrated ATC products only.<sup>373</sup>

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<sup>369</sup> Council Regulation 517/94, n. 185.

<sup>370</sup> Council Regulation 3289/94 amending Regulation 3030/93 on common rules for imports of certain textile products from third countries, OJ, L 349, 31/12/1994, p. 85 – 104.

<sup>371</sup> Ibid.

<sup>372</sup> Ibid, Article (a).

<sup>373</sup> For the products, which have completed the integration, the applicable trading rules were

Second, instruments to implement the major ATC policy, namely the integration and the acceleration programmes, were established. According to the Preamble to Regulation 3030/93, “it is therefore appropriate that the Community quantitative limits provided for in Annex V of Regulation (EEC) No 3030/93 on imports from WTO Members should be amended at each stage of the WTO Agreement on Textiles and Clothing via the procedure provided for in Article 17 of the Regulation and Article 2 (1) of the Regulation should be amended to that effect”.<sup>374</sup> Article 1(7) further stipulated a detailed schedule and the expected progress for each stage.

Third, the strengthened disciplines on circumvention introduced in the ATC were also reflected in Regulation 3030/93, especially with regard to the third countries, which are Members of the WTO but not the actual places of origin or the places of destination of the consignments in question.<sup>375</sup>

The final point refers to the amendments on safeguard measures. On the one hand, a new transitional safeguard system was founded on the basis of Article 6 ATC. On the other hand, the original T&C safeguards, in particular the basket mechanism, was maintained, which was, however, no longer applicable to the WTO members.

#### **4.4 The post-ATC EU regime in T&C**

After the ten-year reform process, the ATC came to an end on January 1, 2005 and general GATT rules took over the T&C sector since then. Accordingly, Regulation 2200/2004 amending Regulation 3030/93 and Regulation 3285/94 was adopted in order to make appropriate adjustments in the EU regime.

The Preamble of Regulation 2200/2004 provided that “to comply with the ATC provisions on the elimination of quantitative restrictions on WTO Members, Annex II to Regulation 3030/93, which confines the application scope of that Regulation, should cover, from 2005 onwards only those non-WTO Members with which the

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established under Regulation 3285/94, which provided for common rules for imports from various sectors and industries, n. 191.

<sup>374</sup> Preamble, Regulation 3289/94, n. 193.

<sup>375</sup> Article 12, Regulation 3289/94, n. 193.

Community has concluded bilateral textile agreements”.<sup>376</sup> Therefore, Regulation 3030/93 is no longer applied to imports from WTO Members and concentrated only on the imports from other sources. Meanwhile, Regulation 3285/94 on the general common rules for imports becomes the exclusive autonomous trade instrument of the EU dealing with T&C products originating in WTO Members.

Furthermore, Regulation 2200/2004 inserted a new surveillance mechanism. This *a posteriori* customs-based system was established to effectively monitor the trends of T&C imports that are no longer subject to the quantitative limits. Compared with the similar mechanism under Regulation 3030/93, where surveillance was deemed as an emergency action and could be invoked only together with safeguards, Regulation 2200/2004 entitles the EU to enforce such action as a routine, or regular, operation in import activities and the existence of emergency situations is no longer required.

In sum, under the current EU regime, T&C imports from WTO Members are subject to the same legislation as products from other industries.<sup>377</sup> One exception could nevertheless be identified: due to China’s additional WTO commitments agreed upon in its accession, the EU surveillance and safeguard mechanisms towards T&C imports from China are separately designated.<sup>378</sup>

#### **4.5 The real driving force in the formulation of autonomous T&C policy: domestic demands from inside the EU**

So far, it has been illustrated in the evolution of EU legislation that the T&C policy development in the GATT/WTO transitional mechanism is always followed by the corresponding adjustments in its domestic trade regime. However, it is also obvious that protectionism has been the mainstream EU policy prevailing in this sector for

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<sup>376</sup> Preamble of Council Regulation 2200/2004 amending Council Regulations 3030/93 and 3285/94 as regards the common rules for imports of certain textile products from third countries, OJ, L 374, 22/12/2004, p. 1 – 28.

<sup>377</sup> The autonomous instrument in this regard was Regulation 3285/94, which has been codified by Council Regulation 260/2009 on the common rules for imports (codified version), OJ, L 84, 31/3/2009, p. 1–17.

<sup>378</sup> For detailed discussions on China’s WTO commitments, see Chapter III. With regard to the second group of supplier countries, which are under bilateral textile agreements with the Community but not WTO Members, Regulation 3030/93 as amended by Regulation 2200/2004, together with the complementation from Regulation 517/94, continues to work as the governing rules. Meanwhile, Regulation 517/94 is still the only Community legislation in charge of the textile imports from third countries in the third group, namely, the supplier countries, which are neither WTO Members nor contracting partners of the Community.

more than 30 years.<sup>379</sup> This domestic proposition is the striking contrast to the constant effort since the 1970s for sectoral integration and quota elimination at the multilateral level. Thus, one might start questioning the compatibility between the EU protectionist policy, on the one hand, and its GATT/WTO commitments for trade liberalisation, on the other. Nevertheless, in most cases, no such problems of compatibility have emerged. Owing to the national discretion preserved under the MFA and the ATC, the EU managed, while guaranteeing the compliance with its international obligations, to maintain its T&C policies mainly untouched.

Even if pressure from the GATT/WTO transitional mechanisms was not strong enough to substantially push forward the sectoral liberalisation, the reasons why the EU chose to maintain such protectionist policy nevertheless deserve further exploration, especially while it has been widely agreed that free trade permits mutual gains for all the trading partners. On this point, it is argued that answers lie in the domestic demands from inside the EU.

In the T&C industry, there are diverse interest groups with different, if not opposite, expectations from the EU trade policy towards third countries. For traders engaged in the exporting or importing business, liberal trading rules encouraging free trade are unquestionably at the centre of their interests. In contrast, for producers, whose products are mainly marketed inside the EU and competing with imports from other countries, protective instruments would be preferred. Therefore, in the decision-making process of the political institutions, a balance has to be made among these competing demands, which will be eventually reflected in the formulation of the trade policy.

The MFA experience provided a clear example in this regard. On the anti-protection side, first of all, European exporters did not consider certain foreign countries, such as India and China, as attractive and beneficial markets until the 1990s. Second, outsourcing the T&C manufacture to low-cost destinations was not yet well developed within the industry. Third, for retailers relying on imported products, the trade interests were rather diffused. Rather than being dominated by large companies, the retail market was shared by hundreds of small and medium

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<sup>379</sup> The outcome of the EU implementation of the MFA and the ATC is analysed in Chapter I Sections 1.3, 2.2.2 and 2.3.3.

enterprises, which were not well organised in claiming their benefits and lobbying among political policy makers.<sup>380</sup>

In contrast, the import-competing producers were hit hard by the growing imports abroad, particularly from China and other Asian countries. Without doubt, they had a lot to gain from tough measures towards T&C imports. On the top of these industrial considerations, during the time period of 1970-1980, T&C production was still an important sector of the economies in many Member States.<sup>381</sup> Although the contribution of the sector to the national revenue had declined relatively over the years, it was still one of the major industries in the EU. In short, the coalition pushing for tough restriction was much stronger than the anti-protection forces.<sup>382</sup>

If the MFA failure in market opening could somehow be explained by the foregoing factors, the situation changed dramatically from the mid-1990s onwards. Major T&C producers turned to improve their competitiveness through focusing on high-value-added products, which, in most cases, target different consumer groups from those of imported products. Meanwhile, subcontracting and relocation of the low-value-added production to foreign countries intensified and thus import quotas were considered as a burdensome cost. Market concentration also gradually emerged in the retail market, which means retailers and importers became better organised through those major large-scale companies. Furthermore, enormous potential in foreign markets like China and India also attracted interest from most European exporters, which proceeded to protest for more liberal trade relations with those countries. Owing to the above elements, together with the more specific and compelling commitments from the WTO, the ATC era indeed witnessed substantive steps towards sectoral liberalisation, especially during the final implementation stage.<sup>383</sup>

On the one hand, compliance with the GATT/WTO obligations is given priority in the shaping of trade policies. On the other hand, the transitional mechanisms preserved marked national manoeuvre and discretion, which left the EU with

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<sup>380</sup> Eckhardt Jappe, 'Carrots, sticks and t-shirts: reflections on the evolution of EU trade policy towards China', paper presented at international workshop "Prospects and Challenges for EU-China Relations in the 21<sup>st</sup> Century: the Partnership and Cooperation Agreement", College of Europe, April 2009.

<sup>381</sup> Ibid.

<sup>382</sup> Ibid.

<sup>383</sup> Ibid.

considerable flexibility in the implementation. As a result, without normative violations of its international commitments, the EU could at the same time take full consideration of the domestic demands. As the experience in T&C presented, the industrial requests might not be in complete compliance, or even in conflict, with the general spirit and aims of the MFA/ATC, they nonetheless turned out to be the major determinants and thus became the real driving force in the policy-making process. This observation provides a realistic, or practical, explanation of the long-standing conflicts between the EU protectionist approaches and the GATT/WTO efforts for sectoral liberalisation. It also reflects the well-known economic proposition that views protection more as a conflict between domestic export interests and importing-competing interests than as a conflict between countries.<sup>384</sup>

## **Section V. EU T&C policy towards China**

It is a conventional practice of the EU to separate China from other exporting countries and establish a specific trading regime towards its exports. This is mainly owing to the previous state-controlled nature of the Chinese economy in the 1970s and 1980s, the robust competitiveness of Chinese exports and the special commitments China made upon its WTO accession.<sup>385</sup>

From the outset of the official bilateral relations in the 1970s, T&C has formed one of the most important issues between these two partners. Alongside the general framework agreements, EU and China have further concluded several sectoral agreements with specific focus on T&C. This section will examine the T&C policy in the bilateral context; in particular, discussion will proceed in accordance with three different period phases, namely the MFA era, the pre-WTO stage and the WTO-integration stage.

### **5.1 The EC-China 1988 Textile Agreement and the EC T&C regime towards China in the early stage**

On April 3, 1978, after more than two years of discussion and negotiation, the EC

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<sup>384</sup> Petros C. Mavroidis, Patrick A. Messerlin, Jasper M. Wauters, *The Law and Economics of Contingent Protection in the WTO*, Edward Elgar Publishing Ltd, 2008, p. 289.

<sup>385</sup> For detailed discussion on China's special commitments under the WTO, see Chapter III.

and China signed their first general trade agreement in Brussels, namely the 1978 Trade Agreement. In 1979, the two parties concluded a separate textile agreement (the 1979 Textile Agreement). After becoming one of the most important T&C exporting suppliers in the world trade, China, although not a Contracting Party to GATT 1947, acceded to the MFA in 1984.<sup>386</sup> Thereafter, the 1979 Textile Agreement was extended through another bilateral document, namely, the 1984 Additional Protocol between China and EC (the 1984 Textile Protocol).

In 1985, a new general agreement on trade and economic cooperation (the 1985 Trade and Cooperation Agreement) replacing the previous 1978 Trade Agreement was concluded, which, to date, constitutes the major legal instrument governing the bilateral trade relations. The principal aim thereof is to intensify and diversify their trade and to actively develop economic and technical cooperation.<sup>387</sup> A couple of years later, an updated sectoral agreement in textile was signed in 1988 (the 1988 Textile Agreement or the 1988 MFA Agreement).<sup>388</sup> Around 1992 – 1993, as a result of the reform in the EU import regime, some changes in the T&C sector were introduced through an exchange of letters amending the 1988 MFA Agreement (the 1992 Amendment Agreement).<sup>389</sup>

### **5.1.1 The 1988 Textile Agreement**

Among other bilateral agreements, the 1988 Textile Agreement deserves particular attention. This Agreement was maintained in force for the longest period, more than 13 years, until China's accession to the WTO; and thus constituted the major sectoral legal framework between these two parties. Furthermore, it was also the first bilateral textile agreement coming into force as part of the transitional mechanism under the MFA.

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<sup>386</sup> China was one of the 23 founding members of the GATT and became a contracting party on May 21, 1948. The Kuomintang Government moved to Taiwan and withdrew from the GATT, May 5, 1950. In 1982, China was granted observer status in the GATT. In June 1986, China requested "resumption" of its contracting party status, on the basis that the withdrawal (by the Kuomintang) was null and void. In May 1987, the GATT established the Working Party on China's Status and China finally became a member of WTO in December 2001.

<sup>387</sup> Agreement on Trade and Economic Cooperation between the European Economic Community and the People's Republic of China, OJ, L 250, 19/09/1985, p. 2-7.

<sup>388</sup> 1988 Agreement between the EEC and China on trade in textile products, n. 134.

<sup>389</sup> Agreement in the form of an exchange of letters amending the Agreement between the European Economic Community and the People's Republic of China on trade in textile products, OJ, L 410, 31/12/1992 p.103 – 124.

The substance of the 1988 Textile Agreement was fairly similar to the bilateral textile agreements concluded between the EC and other supplier countries. Essential trading rules under such agreements have been analysed in the preceding part.<sup>390</sup> However, several new provisions were inserted into the EC-China agreement with regard to particular demand and interest of the European industries. For example, the Agreement included provisions on the guaranteed supply of certain products, according to which China undertook to take such measures as are required to make possible the export of the minimum annual quantities of certain raw materials, including silk, angora and cashmere.<sup>391</sup> Meanwhile, China also committed to give favourable consideration, taking into account its export possibilities, to requests from the Community textile industry with a view to meeting its needs.<sup>392</sup>

While mainly elaborating on the Chinese imports into the EC, the 1988 Textile Agreement also shed light on the EU exports into the Chinese market. According to Articles 12 and 13, China shall encourage and facilitate such importation; if the Community found that it had been placed in an unfavourable position compared with a third country, it may request consultations with China with a view to taking appropriate action consistent with the 1985 Trade and Cooperation Agreement.<sup>393</sup>

### **5.1.2 EC autonomous policy towards China during the MFA era**

On June 12, 1989, the Council adopted Regulation 2135/89 on common rules for imports of certain textile products from China.<sup>394</sup> In general, this Regulation literally transposed provisions under the 1988 Textile Agreement into implementation; and compared with imports from other countries, not many differential treatments, except the anti-surge clause and the flexible quota allocation, were inserted into this China-specific regime.<sup>395</sup>

As a result of the 1992 reform in import regime, the legislation separation between

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<sup>390</sup> For detailed discussion, see Section III.

<sup>391</sup> Article 11, 1988 textile agreement between the EEC and China, n. 134.

<sup>392</sup> Article 7, 1988 textile agreement between the EEC and China, n. 134.

<sup>393</sup> Articles 12 and 13, 1988 textile agreement between the EEC and China, n. 134.

<sup>394</sup> Council Regulation 2135/89, n. 145.

<sup>395</sup> For imports from China, first, the conditions for the Community to impose the anti-surge actions against Chinese imports were stricter than those towards imports from other supplier countries. Second, for third countries' imports, when the import surge was established, both unilateral actions of the Community and VER measures on the part of the exporting country concerned were envisaged, whereas, neither of such instruments was permitted against textile imports of Chinese origin.

China and other supplier countries was terminated. Regulation 2135/89 was then repealed by Regulation 3030/93 and Regulation 517/94, which in combination were in charge of the T&C imports from all sources. It should nevertheless be noted that both Regulations maintained quantitative restrictions against certain Chinese products. In particular, the former set forth restrictions in accordance with the 1988 Textile Agreement, in the form of either fixed annual quotas or safeguard measures under the basket mechanism. Besides, Regulation 517/94 further imposed quotas due to the state-trading nature of the Chinese economy.

As the entry into force of the ATC, the situation became more complicated. On the one hand, significant changes to the EU T&C regime were required at the WTO. On the other hand, however, such changes were not applicable to China, which had not completed its WTO accession by then. Indeed, China obtained its WTO Membership in December 2001, which was almost the end of the second implementation stage of the ATC. Therefore, the coming discussion of the EU autonomous T&C instruments will proceed in the chronological order as follows: the period prior to China's WTO accession will be addressed as the "pre-WTO stage"<sup>396</sup> while the period afterwards as the "WTO-integration stage"<sup>397</sup> until the completion of the ATC integration at the beginning of 2005.

## **5.2 EU T&C policy towards China during the pre-WTO stage**

Different from the MFA, the ATC did not allow accession by states which were not WTO members. It was thus only when China completed its accession to the WTO in December 2001 that the application of the ATC was triggered. Therefore, during the pre-WTO period, there was a "multilateral vacuum" with regard to T&C imports from China in that the previous MFA regime had come to an end but, at that time, could not be succeeded by the ATC.

At the bilateral level, two agreements were maintained in force between the EU and China, namely, the 1988 Textile Agreement, which was negotiated and concluded in accordance with the MFA disciplines, and the new 1995 Agreement on trade in textile products not covered by the earlier Agreement on trade in textile products (the

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<sup>396</sup> From January 1, 1995 to December 11, 2001.

<sup>397</sup> From December 11, 2001 to January 1, 2005.

1995 Textile Agreement).<sup>398</sup> The former has been examined in the previous section. For the 1995 Textile Agreement, it was negotiated and concluded as a transitional resolution for the “multilateral vacuum” mentioned above, which, although initially designed for a two-year period, could be automatically extended for successive periods of one year unless either Party notifies the other otherwise. It is thus reasonable to assume that this Agreement was intended to maintain in force until China successfully acceded to the WTO.<sup>399</sup>

Subsequent to the 1995 Textile Agreement, the EU and China made four amendments in the form of exchange of letters, which introduced three major changes to the bilateral trade relations in T&C.<sup>400</sup> First, the application of both the 1988 and 1995 Agreements was continuously extended until December 31, 2001, which thus expired shortly after China’s accession to the WTO. Second, national treatment and MFN clauses were inserted regarding the EU exports into the Chinese market.<sup>401</sup> The final modification referred to the method of adjustments in the quantitative restrictions and the method of administration, which aimed to provide a passage to ensure and facilitate a smooth transition into the ATC regime.<sup>402</sup> This intention was clearly reflected in the last amendment in 2000, which was particularly prepared for the imminent ATC application including a specific administrative

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<sup>398</sup> Agreement between the European Community and the People's Republic of China on trade in textile products not covered by the MFA bilateral Agreement on trade in textile products initiated on 9 December 1988, OJ, L 104, 06/05/1995, p.2 – 29.

<sup>399</sup> Generally speaking, the 1995 Agreement established similar import disciplines as those under the 1988 Agreement. First and foremost, annual quantitative restrictions on the most sensitive T&C products and the basket mechanism safeguarding products not subject to quotas were both maintained. Furthermore, other substantive provisions, such as those on anti-concentration, flexibility and prevention of circumvention, were also included. Articles 5, 8 and 9, the 1995 non-MFA agreement.

<sup>400</sup> Agreement in the form of an Exchange of Letters between the European Community and the People's Republic of China amending the Agreement between the European Economic Community and the People's Republic of China on trade in textile products as last amended by Agreements initiated on 14 December 1994 - Agreed Minute Unofficial translation, OJ, L 81, 30/03/1996, p.318 – 389; Agreement in the form of an exchange of letters between the European Community and the People's Republic of China amending the Agreement between the European Economic Community and the People's Republic of China on trade in textile products as last amended by Agreements initiated on 13 December 1995 - Agreed Minutes OJ, L 12, 16/01/1999, p.28 – 71; Agreement in the form of exchange of letters between the European Community and the People's Republic of China initialled in Beijing on 6 December 1999 amending the Agreement between the European Economic Community and the People's Republic of China on trade in textile products as last amended by an agreement initiated on 20 November 1999 and amending the Agreement between the European Community and the People's Republic of China initiated on 19 January 1995 on trade in textile products not covered by the MFA bilateral Agreement OJ, L 345 , 31/12/1999, p.2 – 35; Agreement in the form of an Exchange of Letters between the European Community and the People's Republic of China initiated in Beijing on 19 May 2000 amending the Agreement between them on trade in textile products and amending the Agreement between them initiated on 19 January 1995 on trade in textile products not covered by the MFA bilateral Agreement, OJ, L 314, 14/12/2000, p.14 – 26.

<sup>401</sup> Para 2.2, 1996 Amendment Agreement; Para 2.1, 1999 Amendment Agreement, n. 223.

<sup>402</sup> Para 4, 1999 Amendment Agreement; 2000 Amendment Agreement, n. 223.

arrangement for this purpose.

Within the EU, import legislation governing T&C products from China had, to a large extent, maintained the *status quo* during the pre-WTO stage. Regulations 3030/93 and 517/94 retained the major autonomous instruments in this regard. There was, however, one remarkable change. In January 1995, China was removed from Annex IV and Annex V of Regulation 517/94, which signified that T&C imports from China were no longer subject to the annual quotas arising from the state-trading nature of its economy.<sup>403</sup>

### **5.3 EU T&C policy towards China during the WTO-integration stage**

China's accession to the WTO filled the multilateral vacuum in T&C. Within the EU, T&C imports from China, as those from other WTO Members, were regulated by the combination of Regulations 3030/93 and 3285/94 during the WTO-integration stage.<sup>404</sup> However, due to the special commitment agreed on under China's WTO membership,<sup>405</sup> imports of Chinese origin were further subject to a T&C safeguard mechanism under Article 10(a) of Regulation 3030/93 until 2008.

When the integration process of T&C approached the final stage, worries nevertheless arose from inside the EU with regard to the potential disruption in the domestic market and industries subsequent to the removal of quotas and the overall opening of the market at the beginning of 2005. This competitive pressure was also considered as being driven chiefly by China, whose formidable production and export capacity would quickly reinforce its status as one of the world's largest producers and exporters of T&C products. Managing this transition presented a challenge to both China and the EU which has domestic industries of its own.

Hence, in order to guarantee the Chinese T&C products a smooth transition into the quota-free trade environment and a normal and sustainable operation of the European markets and industries, in May 2004, representatives of both sides agreed

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<sup>403</sup> Council Regulation 1325/95 amending Regulation 517/94 on common rules for imports of textile products from certain third countries not covered by bilateral agreements, protocols or other arrangements, or by other specific Community import rules, OJ, L 128, 13/06/1995, p.1-5.

<sup>404</sup> For detailed discussion, see Section 4.3.

<sup>405</sup> For detailed discussion, see Chapter III Section III.

to set up a high-level dialogue mechanism to address the important trade issues of common interest in this sector. As the outcome of the negotiations, the mechanism of the EU-China Textiles Trade Dialogue was established, the principal target of which was to ensure that trade in T&C proceeded smoothly after the elimination of quotas on January 1, 2005.

In the quota-free T&C trade after 2005, on the one hand, the volume increase, or import surge, from China has been significant in the EU market. On the other hand, the lifting of quantitative restriction did not leave the EU completely unarmed. When domestic demands for protection or adjustment arose, the EU was never hesitant in invoking contingency instruments in the form of TDI. This is not only because of China's enormous export and production capacity in T&C. More importantly, the EU, based on the authorisation from the WTO, frequently resorts to the transitional contingent mechanisms towards China, which considerably facilitate and simplify the imposition of restriction.<sup>406</sup>

## ***Chapter conclusions***

In the centre of the EU trade policies, the CCP is based on the link between the functioning of the internal market and the economic interactions with the rest of the world. One of the most significant features of the CCP is the co-existence and combination of the internal and external measures confirmed by the Court in *Opinion 1/75*. Those measures are known as the Community's autonomous and contractual commercial instruments respectively. In most cases, the former, in the form of Community legislation, is adopted with the aim of providing proper implementation for the external commitments stipulated in international agreements to which the EU is a party.

The relationship between these two types of CCP instruments is closely linked to the reception of international law within the EU legal order. Insofar as trade issues are concerned, it could be well explained through a discussion on the impact of the GATT/WTO on the EU.

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<sup>406</sup> For detailed discussion, see Chapter IV.

In this regard, direct effect of the GATT/WTO law has been constantly denied in the European Court, which means neither the Member States nor the individual traders are able to invoke these rules to contest the legality of EU measures. In spite of the closure of the “main entrance” in direct effect, the Court has followed a rather deferential approach under other circumstances where the “side passages” are widely open. This is particularly the case in the areas of anti-dumping, in the application of the Trade Barriers Regulation and during the interpretation course of the EU law and the law of Member States. Furthermore, a fair proactive approach towards WTO rules has also been witnessed among the political institutions of the EU, especially in the process of formulating trade policies, either within the Community, or with its trading partners. Therefore, WTO law has acquired a central role and become the major benchmark in EU’s CCP activities nowadays.

The EU T&C trade regime consists of both types of instruments. At the international level, it concluded an extensive web of bilateral textile agreements under the multilateral transitional mechanisms of the MFA. These agreements were characterised by VERs, the basket mechanism and the sub-division of the global quotas among the Member States.

At the autonomous level, the first harmonised T&C system came into force around 1992-1993 after the completion programme of the internal market, which was earlier preceded by a regime incorporating both the Community and the national policies of the Member States. Two major pieces of legislation were adopted, namely, Regulations 3030/93 and 517/94, bringing the sector from the scattered national-running operations into a unified system. The most noticeable achievement was that the global T&C quotas, although still in existence, were no longer broken down into Member States’ shares. Shortly after, the second round of reform took place in response to the entry into force of the WTO. Major changes were introduced by Regulation 3289/94, which added an extension part to Regulation 3030/93 with the aim of implementing the T&C-specific rules in the ATC. After a ten-year reform process and as a result of the sector integration into the GATT, from 2005 onwards, Regulation 3285/94 on common rules for imports became the dominant EU instrument governing the T&C trade, as well as products from other industries, with WTO Members.

The preceding discussion on the T&C-specific regime might dilute the attention which should have been paid to the most frequently used contingency instrument in the sector, namely, the TDI in the form of anti-dumping. Indeed, no rules in this regard were included in the transitional mechanism in T&C, which nonetheless constitutes one of the most targeted sectors in EU's anti-dumping practice. The statistics on sectoral trends targeted over the past ten years are a clear indicator that a high proportion of anti-dumping investigations have been concentrated in sectors where production has shifted to other countries and the standard European pattern is in decline.<sup>407</sup> The T&C sector turned out to be one of them, which shared 10 per cent of the total investigations initiated during 1998-2008, ranking at the fourth place after chemicals, steel and technological.<sup>408</sup>

In contrast, as the only sector-specific TDI, special safeguards were much less invoked in practice. During the period 1996-2005, the EU launched in total 52 T&C anti-dumping investigations while no safeguards were ever initiated.<sup>409</sup> It thus raises the question as to the reasons why the contingency instruments designated with particular sector target were much less popular than those with general applicability across all the industries. This query will be investigated in-depth in the subsequent chapters. Here, suffice it to say, insofar as the EU regime is concerned, there was a clear policy preference among different approaches to achieve the protectionist objective in the T&C trade.<sup>410</sup>

The final observation to be made in this chapter concerns the real “driving force” underlying the evolution of the EU trade policies. As analysed earlier, amendment and reform in autonomous T&C instruments were inspired and stimulated by either the policy development at the GATT/WTO or the domestic demands from the market and the industries. For the GATT/WTO commitments, all the changes under the transitional mechanism were followed by parallel adjustments in the EU T&C regime. This routine was clearly presented in the MFA and the ATC experience. However, the corresponding implementation in the domestic regime was not always

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<sup>407</sup> Lucy Davis, ‘Ten years of anti-dumping in the EU: economic and political targeting’, ECIPE Working Paper, 02/2009, available at <http://www.ecipe.org/ten-years-of-anti-dumping-in-the-eu-economic-and-political-targeting/PDF>, p.6.

<sup>408</sup> Ibid.

<sup>409</sup> Statistic information from [http://www.wto.org/english/tratop\\_e/safeg\\_e/safeg\\_e.htm](http://www.wto.org/english/tratop_e/safeg_e/safeg_e.htm) and [http://ec.europa.eu/trade/issues/respectrules/anti\\_dumping/stats.htm](http://ec.europa.eu/trade/issues/respectrules/anti_dumping/stats.htm).

<sup>410</sup> For detailed discussions regarding the policy preference among different contingency instruments, see Chapter IV Section 3.1.

in full compliance, or at the same pace, with the development expected at the GATT/WTO; and, to a certain extent, multilateral policy flexibility tolerated the existence of national discrepancies. For instance, under the MFA/ATC strategy towards market opening and sector integration, autonomous policies of the EU witnessed a strong trend of protectionism, notably in the wide use of quantitative restrictions and the prevalence of sectoral TDIs. During the MFA era, the EU basket mechanism introduced a more restrictive safeguard system than Article 3 MFA;<sup>411</sup> and under the ATC, the EU, through dramatically inflating the original quota list, actually maintained in force 70 per cent of its quotas, which was regarded as a deliberate back-loading of the acceleration programme.<sup>412</sup>

In contrast, the industry and market development within the EU, as well as the structural changes thereof, provided a better explanation than the MFA/ATC mandates for the evolution of domestic policies. It is worth noting that substantive reform in T&C did not take place so many years after the aim of sector liberalisation was first introduced under the MFA in the 1970s but immediately happened when the internal market needed to be completed. In particular, in the early 1990s, in order to extinguish the policy discrepancy among the Member States and to achieve the uniformity of the internal market, the reform project in T&C achieved outstanding success in the lifting of national restrictions, as well as the quota sub-division system of the Community. Furthermore, in spite of the back-loading schedule of the ATC implementation submitted in 1995, the EU gradually turned to a more liberal approach in this sector from the late 1990s, which was mainly driven by the increased requests and integrated lobbying powers of the anti-protection groups.

In a nutshell, experience in the T&C sector indicated that domestic demands have played a much more important role than the external commitments in steering the formulation of the EU trade policies. While actions of a reactive nature were not uncommon in the MFA/ATC implementation process, a fairly proactive approach has been followed in response to the requests arising from inside the EU. Furthermore, in spite of the general primacy of international obligations, where conflict arose with domestic interests, the EU would not hesitate to succumb to the latter even at the price of committing a violation of its conventional obligations at the international

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<sup>411</sup> For detailed discussion, see Section 3.1.

<sup>412</sup> For detailed discussion, see Chapter I Section 2.3.3.

level. However, the reality is, because of the implementation and interpretation flexibility permitted under the transitional mechanisms, the EU in most cases managed to comprehensively defend its domestic interests without breaking the obligatory GATT/WTO commitments. Therefore, rather than such international commitments, it is the domestic demands, from the European industries, the internal market and the private operators, that constitute the real “driving force” of EU’s trade policy. Furthermore, such “policy indulgency” of the domestic demands also discloses the need, at the multilateral forum, to decrease the national flexibilities in the implementation process with the aim of a more regularised and efficient sectoral integration reform.

After the preceding research on the transitional mechanisms in T&C and their implementation in the EU, the ensuing chapters will move onto exploring the similar mechanism affiliated to the WTO membership of China. Particular emphasis will be once again placed on the application of the relevant contingency instruments thereunder and their application in EU’s practice. In the meanwhile, sectoral study in T&C will continue in terms of the special safeguard mechanism agreed upon in China’s accession documents.

## **CHAPTER III. The WTO CONTINGENT TRADE INSTRUMENTS AGAINST CHINA: WHAT DOES THE ACCESSION BRING?**

### ***Introduction. China's WTO accession and the relationship between the accession documents and the WTO agreements***

On December 11, 2001, China completed its accession process to the WTO and became a Member thereof. Given its rapid economic expansion, China's entry into the WTO has significant implications for the rest of the world. In 2005, China ranked as the third largest exporter and importer in world trade. The value of its merchandise exports reached US\$ 761 953 million, which constituted 7.28 per cent of world exports; meanwhile, China also imported US\$ 659 953 million worth of merchandise representing 6.09 per cent of the total world value of imports.<sup>413</sup>

According to Article XII of the WTO Agreement, "any state or separate custom territory...may accede to this Agreement, on terms to be agreed between it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto". In the case of China, the WTO accession documents consist of two major parts: the Protocol on the Accession of the People's Republic of China (the Accession Protocol)<sup>414</sup> and the Report of the Working Party on the Accession of China (the Working Party Report)<sup>415</sup>.

With regard to the relations between the accession documents and the generally applicable WTO rules, Section 1.2 of the Accession Protocol provides that "this Protocol, which shall include the commitments referred to in paragraph 342 of the Working Party Report, shall be an integral part of the WTO Agreement". Two observations could be derived from this provision. First of all, as an integral part of the WTO Agreement, the principle of cumulative application applies.

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<sup>413</sup> Information available at <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=CN>.

<sup>414</sup> Protocol of China's Accession to the WTO, available at <http://docsonline.wto.org/DDFDocuments/t/WT/L/432.doc>.

<sup>415</sup> Report of the Working Party on the Accession of China, available at <http://docsonline.wto.org/DDFDocuments/t/WT/min01/3.doc>.

According to this principle, Members' WTO obligations are cumulative and Members must comply with all these obligations at all times unless there is a formal "conflict" between them.<sup>416</sup> Therefore, in most cases, WTO trading rules apply to China alongside the trading rules included in the accession documents. As concluded in the previous discussion with regard to the relationship between the T&C transitional mechanisms and the GATT/WTO, two major functions of the latter can be confirmed.<sup>417</sup> They provide the normative background that comes in to fulfil aspects of the operation not specifically provided in the accession documents; moreover, they also come into operation if the special regime fails to function properly.

Second, the situation becomes different when normative conflict, in a narrow sense, arises. Unlike the multilateral agreements on trade in goods in Annex 1A, where a particular interpretative note is included to deal with conflicts among different WTO rules, nowhere in the accession documents is this issue mentioned. However, a statement was laid down in Section 1.3 of the Accession Protocol, according to which, "except otherwise provided for in this Protocol, those obligations in the Multilateral Trade Agreements annexed to the WTO Agreement that are to be implemented over a period of time starting with entry into force of that Agreement shall be implemented by China as if it had accepted that Agreement on the date of its entry into force". This provision assumes the priority of the Accession Protocol in the case of "express derogation", which has been analysed in the ATC-WTO context; and thus, subject to the cross reference specified in the text, provisions under the Accession Protocol shall prevail over the WTO rules concerned.<sup>418</sup> For the irreconcilable normative conflict, without the help from the so-called "conflict clause", recourse shall be made to the *lex specialis* and *lex posterior* principles under general international law, according to which the special rule overrides the general rule and the later rule overrides the earlier rule.<sup>419</sup> However, neither the WTO rules nor the existing jurisprudence has provided a definitive answer to the question raised so far; therefore, debates regarding the relationship between the accession documents and different WTO agreements, the conflict resolutions between them and the interpretive approach

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<sup>416</sup> For detailed discussion, see Chapter I Section 2.1.

<sup>417</sup> For detailed discussion, see Chapter I Conclusion.

<sup>418</sup> The issue of "cross reference" and "express derogation" has been discussed in Chapter I Section 2.1

<sup>419</sup> For detailed discussion, see Chapter I Section 1.1.

towards the former, remain open.<sup>420</sup>

Upon its accession, China not only assumed all the obligations in the WTO agreements, it also undertook a number of additional commitments included in the accession documents. In general, those commitments could be divided into two different categories: the WTO-plus obligations and the WTO-minus disciplines and rights.<sup>421</sup> These two groups of China's specific WTO obligations represent a transitional, or interface, mechanism for NMEs in the WTO. While at the same time accommodating the possibility that portions of such economies might move towards a market orientation, such a mechanism establishes a "two-track" safeguard system, which respectively corresponds to China's WTO-plus and WTO-minus obligations under the accession documents.<sup>422</sup>

There is a fundamental difficulty between the NME and the WTO concerning the underlying assumption of the multilateral tariff system. In particular, the tariff system presupposes that importation and exportation are handled by private firms which, stimulated by profit motives, are guided by commercial considerations. Therefore, decisions of these firms to import and export are determined by the relation of domestic prices to foreign prices. Based on this assumption, the function of the WTO is to limit the influence that governmentally imposed rules may exert upon the decision-making of private companies. However, when one considers state trading, the underlying assumption of this system is itself no longer applicable.<sup>423</sup>

The WTO-plus obligations mainly focus on the required reform in domestic legal and economic systems, which are intended to facilitate the implementation of China's WTO commitments. In particular, they highlight improvements in a series of issues, including but not limited to transparency, procedural fairness, judicial review, sub-national governments, transitional policy review, market

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<sup>420</sup> Interpretation of China's accession documents and their relations with other WTO agreements have already been raised in several pending WTO disputes. No rulings have been issued so far.

<sup>421</sup> Julia Ya Qin, 'WTO-plus Obligation and Their Implication for the WTO Legal System', *Journal of World Trade*, (2003) 37, 483-522.

<sup>422</sup> John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations*, MIT Press, Cambridge, 1997, p. 331-332.

<sup>423</sup> Kenneth W. Dam, *The GATT: Law and International Economic Organization*, University of Chicago Press, 1970, p 318.

economy commitments and national treatment of foreign investors. Those requirements are China-specific in the sense that it is not a common practice in the context of WTO accessions to establish such extensive obligations regarding the domestic reform of prospective Members.<sup>424</sup> Most of these obligations are aimed at guaranteeing a fair trading environment and creating a level commercial playing field. In this way, they can be considered mutually beneficial to both China and its WTO trading partners.

In contrast, the WTO-minus disciplines possess a different object. In particular, they are special rules of conduct that at once weaken the existing WTO disciplines and reduce the rights of China as a WTO Member. Under the WTO-minus disciplines, a buffering mechanism, as a traditional GATT practice prior to 1995, was designed for exceptional cases involving the difficult interface in the NMEs. In order to alleviate injury caused by the differences in economic structures, such mechanism normally comprises special contingency trade measures, particular consultation procedures and negotiating requirements, and so forth.<sup>425</sup> In spite of the potential inconsistency with economic arguments of liberal trade, the buffering mechanism indeed provides a pragmatic solution to minimise the suspicions and tensions that could otherwise occur.<sup>426</sup>

The GATT era witnessed the accessions of several state-trading countries, or NMEs, which benefited from the buffering mechanism.<sup>427</sup> In particular, specific reference was made to Ad Article VI GATT under the mechanism, which indicates a special methodology in the anti-dumping proceeding and a selective safeguard mechanism. However, this practice was suspended after the establishment of the WTO in 1995 and all the newly acceded WTO Members, including those of NMEs, are no longer subject to this mechanism, all except China. The most likely explanation for China's exception might lie in its remarkable economic influence on the world trade nowadays; and for the largest NME, the otherwise outdated GATT practice is revived. Relevant provisions are included under Sections 15 and 16 of the Accession Protocol, which respectively stipulate price comparability in determining subsidies and dumping and the

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<sup>424</sup> Julia Ya Qin, n.9.

<sup>425</sup> John H. Jackson, n.10, p. 331-332.

<sup>426</sup> Ibid.

<sup>427</sup> GATT accessions of Poland, Romania and Hungary.

transitional product-specific safeguard mechanism.

This chapter will examine the buffering mechanism under China's accession documents, which comprises and specifies the special contingency instruments under the overall transitional mechanism affiliated to its WTO membership. It first looks into the instruments generally afforded to WTO Members, namely, the anti-dumping and the safeguards. Furthermore, a specific survey will be provided in the T&C sector. Owing to the intervallic competitive advantages enjoyed by China and the sectoral sensitivity of the domestic industries in most WTO Members, a T&C safeguard mechanism has been negotiated and concluded under Para 242 of the Working Party Report.

### ***Section I. Section 15 of the Accession Protocol: the anti-dumping regime towards China as a NME***

Section 15 is usually considered as the authoritative WTO text permitting, or confirming, the non-market status of China's economy. A special approach of price calculation in anti-dumping investigation is stipulated under subparagraphs (a) and (d), which are thus worth being quoted in full:

“(a) In determining price comparability under Article VI of the GATT 1994 and the Anti-Dumping Agreement, the importing WTO Member shall use either Chinese prices or costs for the industry under investigation or a methodology that is not based on a strict comparison with domestic prices or costs in China based on the following rules:

- (i) If the producers under investigation can clearly show that market economy conditions prevail in the industry producing the like product with regard to the manufacture, production and sale of that product, the importing WTO Member shall use Chinese prices or costs for the industry under investigation in determining price comparability;
- (ii) The importing WTO Member may use a methodology that

is not based on a strict comparison with domestic prices or costs in China if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to manufacture, production and sale of that product.

(d) Once China has established, under the national law of the importing WTO Member, that it is a market economy, the provisions of subparagraph (a) shall be terminated provided that the importing Member's national law contains market economy criteria as of the date of accession. In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession. In addition, should China establish, pursuant to the national law of the importing WTO Member, that market economy conditions prevail in a particular industry or sector, the non-market economy provisions of subparagraph (a) shall no longer apply to that industry or sector.”

The general tenor of the quoted text is that, unless the Chinese producers can clearly and accurately show that market economy conditions prevail in the industry under investigation, the importing WTO Member has the privilege of using a methodology different from the one of general applicability stipulated for market economy. Once China is able to prove that it meets the established criteria in the importing Member, the relevant anti-dumping rules under Article VI GATT and the ADA should apply.

Before looking into this special mechanism respecting China, it is necessary to first start with a brief review of the standard anti-dumping methodology under the WTO agreements. In short, dumping is generally recognised as a situation of international price discrimination, where the price of a product when sold in the importing country is less than the price of the same product in the market of the exporting country. The WTO allows its Members to take actions against dumping practice where there is material injury to their domestic industries. In particular, Article VI GATT and the ADA permit importing Members to act in a way that would normally break their obligations in tariff concessions and typically, anti-dumping action means charging extra import duty on the particular product from the particular exporting Members in order to remove the injury to domestic

industry caused by the dumped imports.<sup>428</sup> In order to do that the importing Member has to be able to prove that dumping is taking place, to calculate the extent of dumping, and to show that the dumping is causing injury or threatening to do so.<sup>429</sup>

In the simplest of cases, dumping can be identified through comparing prices in the exporting and importing markets. However, situations in practice are usually far more complex and it is thus required to undertake a series of sophisticated analytical steps to determine the appropriate price in the market of the exporting country, known as the “normal value”, and the appropriate price in the market of the importing country, known as the “export price”, before carrying out the comparison between them.

According to the ADA, there are three methods of calculating a product’s “normal value”. The primary one is based on the product price in the exporter’s domestic market.<sup>430</sup> When this cannot be used, two alternative options are available, which refer to the price charged by the exporter in another third country, or a calculation based on the combination of the exporter’s production costs, other expenses and normal profit margins.<sup>431</sup> What they have in common is that all the relevant information shall be collected from the market of the exporting country.

In the meantime, “export price” in the importing market is calculated for the individual exporter, which is normally reflected as the transaction price at which the foreign producer sells the product to an importer in the importing country. The comparison between normal value and export price is usually carried out either on a weighted average basis or on an individual transaction basis.<sup>432</sup> The outcome of this comparison demonstrating the extent of dumping is called the “dumping margin”, which is one of the major determinants of the amount of anti-dumping duties to be imposed. In particular, the duty amount is dependent on either the dumping margin between export price and normal value, or the damages caused to the domestic industries in the importing country, whichever is

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<sup>428</sup> Article VI (2) GATT.

<sup>429</sup> Article VI (1) GATT.

<sup>430</sup> Articles 2.1 and 2.2 ADA.

<sup>431</sup> Ibid.

<sup>432</sup> Article 2.4.2 ADA.

lower.

Hence, in comparison with the general WTO anti-dumping system, two major policy discrepancies arise from the transitional mechanism under Section 15 of the Accession Protocol. In particular, it not only disregards the domestic information from China as the exporting country; furthermore, it also adopts a different approach of price comparison in the calculation of the dumping margin.

### **1.1 The market economy conditions and the non-market economy treatment**

Section 15 finds its origin in Ad Article VI GATT, which provides that “in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purposes of paragraph 1, and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate”.<sup>433</sup> Therefore, in the anti-dumping investigation, the importing WTO Member is entitled to apply a different, or special, methodology to a centrally planned economy country.

Two issues nevertheless emanate from this brief provision. First, in a strict sense it applies only to countries where there is a complete or substantially complete monopoly of trade, and where all prices are fixed by the state. In today’s world there have remained practically very few countries that would qualify under the prescribed criteria.<sup>434</sup> Even before the decline of the Soviet Union, such countries were hard to find, and it is unlikely that any of the countries classified as NMEs today fit this description.<sup>435</sup> Second, Ad Article VI GATT is no more than a statement of fact that prices might not be appropriate for comparison, which provides no specific indications as to what course of action the investigating

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<sup>433</sup> Notes and Supplementary Provisions on Paragraph 1 Article VI, Annex I to the GATT.

<sup>434</sup> Alexander Polouektov, ‘Non-market economy issues in the WTO anti-dumping law and accession negotiations: revival of a two-tier membership?’, *Global Trade and Customs Journal*, (2002) 36, 1-37, p.14.

<sup>435</sup> Helena Detlof and Hilda Fridh, ‘The EU treatment of non-market economy countries in anti-dumping proceedings’, *Global Trade and Customs Journal*, (2007) 2, 265-281, p.268.

authorities should take in dealing with a centrally planned economy.

It is thus rather questionable whether this provision can reasonably be considered as a WTO definition of NME. On the contrary, it seems more appropriate to regard such a description as an extreme instance and the term “NME” could be better understood as a fluid formulation: a broader concept of an economy in transition, contemplating not only a narrow concept found in Ad Article VI and incorporating the existence of both market and non-market characteristics.<sup>436</sup> A dichotomous approach shall be avoided with regard to the relationship between NME and market economy simply because these two terms should not be conceived as the entirely opposite side of each other. If we define NME by reference to a market economy, the concept and features of the latter, at the maximum, provide only a starting point of this course, for example, merely being as different from a market economy or more usually as lacking or displaying specific features.<sup>437</sup>

All the previous GATT accessions of NMEs, namely, Poland, Romania and Hungary, witnessed similar provisions to those under Section 15. However, none of these provisions made explicit reference to the term “market economy conditions” (MECs) or NME. Thus, although the buffering mechanism under Section 15 is not a new invention, it is indeed the first WTO provision that explicitly employs, or introduces those concepts.<sup>438</sup> However, it seems potentially problematic that, rather than setting forth further criteria or detailed definitions, Section 15 submits the issues to the autonomy of the importing Member. According to Section 15(d), the application of Section 15 shall be terminated earlier than originally scheduled upon the fulfilment of domestic standards for market economy by China.<sup>439</sup> Through this explicit permission for national standards, Section 15 indeed indicates the co-existence of diverse MECs among the WTO Members.

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<sup>436</sup> Changho Sohn, ‘Treatment of Non-market Economy Countries under the World Trade Organization Anti-dumping Regime’, *Global Trade and Customs Journal*, (2005) 39, 763-786, p.767.

<sup>437</sup> Francis Snyder, ‘The origins of the non-market economy: ideas, pluralism and power in EC anti-dumping law about China’, *European Law Journal*, (2001) 7, 369-434.

<sup>438</sup> For “market economy condition”, see Section 15(a) and (d); for “non-market economy”, see Section 15(d).

<sup>439</sup> According to Section 15 (d), the special methodology could be maintained, at the maximum, 15 years after the date of accession.

With regard to the same concept, the lack of uniform criteria and the tolerance of varying standards lead to erosion of integrity under the WTO system. Depending on the investigating authorities and the criteria applied, the same country at the same time may well be considered as both a market and non-market economy by different Members.<sup>440</sup> It is indeed intriguing that China, apart from the general commercially viable terms acceptable to all WTO Members, is still subject to such treatment on the basis of unilateral consideration. The far-reaching negative implications of such an approach for the integrity and smooth operation of the WTO system are hard to overestimate.<sup>441</sup> Furthermore, the discretion of the importing Member to decide whether China is a qualified market economy considerably enhances the dependence, or reliance, on bilateral approaches among WTO Members. Reliance on bilateralism, especially with regard to the policy of trade-restrictive effect under the transitional mechanism, is proven to have encumbered the sectoral reform in T&C to a large extent.<sup>442</sup> More importantly, it renders the bilateral negotiation process more akin to bargaining between governments than an objective economic assessment in domestic economy. It has already been argued that political motivation played an important role while the relevant decision was being taken on NME issues,<sup>443</sup> especially following the pressure from the affected domestic industries.

## **1.2 Applicability of the standard anti-dumping disciplines to China**

As a general principle, WTO obligations are cumulative in nature and Members must comply with all of them at all times unless there is a formal "conflict" between them.<sup>444</sup> Thus, in most cases and insofar as products of Chinese origin are concerned, Article VI GATT and provisions under the ADA shall apply together with Section 15. In the case of conflict, recourse shall be made to the heading paragraph of Section 15. In particular, it is provided that Article VI

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<sup>440</sup> Alexander Polouektov, n.22, p.30.

<sup>441</sup> Ibid.

<sup>442</sup> As the MFA experience demonstrated, protectionist policies included under the bilateral textile agreements are the main reason for the failure in sectoral liberalisation before the 1990s.

<sup>443</sup> Alexander Polouektov, n. 22, p.24.

<sup>444</sup> *EC-Bananas*, Panel Report, WT/DS27/R, para. 7.160; *Guatemala-Cement*, Appellate Body Report, WT/DS60/AB/R, para.65; *Korea-Dairy*, Appellate Body Report, WT/DS98/AB/R, paras.76-77; *Argentina-Footwear*, Appellate Body Report, WT/DS121/AB/R, paras 83-89; *Turkey—Textiles*, Appellate Body Report, WT/DS34/AB/R, para. 9.92.

GATT and the ADA shall apply consistently with the provisions in this Section, which thus, to a certain extent, indicates the priority entrusted to the China-specific rules.<sup>445</sup>

However, Section 15 merely outlines the special methodology at the stage of price comparison and does not elaborate on other issues involved in the investigation process. Therefore, the application of Article VI GATT and the ADA is not only required by the principle of cumulative application, such provisions also constitute the general background against which Section 15 should be viewed.

This combined application, on the one hand, allows WTO Members to maintain their NME treatment towards imports of Chinese when the issue of dumping practice arises. On the other hand, it immediately entitles China to the full range of procedural rights and the vast majority of the substantive rights contained in the ADA.<sup>446</sup> In other words, all WTO Members will now be bound by international law to apply their NME regime in a manner consistent with the various due process and factual assessment standards contained in the ADA.<sup>447</sup> This argument receives further support from the Working Party Report. In particular, with the aim of guaranteeing the rights of interested parties, especially of Chinese producers and exporters, Para 151 establishes a series of procedural obligations on the part of the importing WTO Member, most of which correspond to the requirements set forth in Articles 6 and 8 of the ADA.<sup>448</sup>

Therefore, the China-specific rules under Section 15 of the Accession Protocol and Para 151 of the Working Party Report cannot exclude the standard WTO disciplines in anti-dumping, the application of which is not only compulsory but also essential in terms of the established WTO jurisprudence and the requirement for procedural fairness. However, according to the conflict clause under Section 15, as well as the principles of *lex specialis* and *lex posterior*, the anti-dumping rules under the accession documents would prevail where conflict, narrowly

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<sup>445</sup> First paragraph, Section 15, Accession Protocol.

<sup>446</sup> Andrea Mastromatteo, 'Anti-dumping rules in China's Accession Protocol: timely benefits for traders of foreign and Chinese origin', *International Trade Law and Regulation*, (2002) 8, 75-78.

<sup>447</sup> *Ibid.*

<sup>448</sup> These two Articles of the ADA respectively concern evidence and price undertakings.

defined, emerges.

### **1.3 The special methodology towards China as a NME**

The special treatment under Section 15 refers to a methodology that is not based on a strict comparison with domestic prices or costs of exporting market. The question thus arises as to what this special methodology stands for. The text of Section 15 makes it clear only that approaches other than those entirely based on data from China are permitted, but it fails to clarify the extent of deviation allowed thereunder. Compared with the general WTO anti-dumping regime, this Section neither delineates what approaches this methodology should entail, nor does it explain how such new approaches should be operated in practice.

Two interpretations may arise from the text, depending on the literal emphasis on either the phrase “domestic prices or costs” or “strict comparison”. In the former case, Section 15 shall be understood to indicate the use of prices and costs from another market economy country, as opposed to China. The data collected will be used in the calculation of normal value, which will later be compared with export price to measure the dumping margin. Otherwise, if the literal emphasis lies in the term “strict comparison”, what the special methodology aims at is simply the adjustments during a “flexible comparison” process in the determination of the dumping margin. In the latter case, the data used in the investigation shall nevertheless be all collected from China and reference to another third country of market economy is excluded; however, the investigation outcome cannot come straightforward from the data collected and due allowance has to be made during the comparison. That is to say, in order to measure the dumping margin of a particular import category from China, the difference between the normal value and the export price is not sufficient due to the involvement of other elements relating to the NME nature of the Chinese economy.

The argument in support of both interpretations nonetheless emerges, according to which, the NME methodology should prevail during the entire process of investigation, including the calculation of normal value and the analysis of export price as well as the comparison between them. Indeed, practice, to a large extent,

reflects this argument: the most widespread methodology among WTO Members, which will be examined in the following section, is the combination of the so-called analogue country approach as regards the normal value and the principle of one country-one duty related to the export price.<sup>449</sup>

### 1.3.1 The NME methodology in practice

Under the analogue country approach, rather than relying on the data collected from the NME market and industry to calculate normal value, investigating authorities in the importing Member are entitled to use data from another reference market economy country instead. Thus, the normal value of such exports will not be taken as the price payable on the domestic market, but will be determined on the basis of the price or contracted value in an analogue third country.<sup>450</sup>

The underlying rationale of this approach is that prices do not have exactly the same functions in NMEs and market economies. In a NME, the price does not typically influence the quantities produced. Rather the quantities to be produced are stipulated by the planning authorities, which have previously set economic goals for the country and are seeking the allocation of resources accordingly. Therefore, prices and costs in the NME could be easily and considerably influenced by factors other than the market force, i.e. governmental control, and as a result, could not be relied upon in the anti-dumping investigation. In a market economy, the price of a particular product tends to influence not only the quantities that are consumed but also the quantities that are produced. Prices will tend to reflect consumers' preferences and will adjust to eliminate shortages and surpluses for all products. Therefore, the relationship between domestic and foreign prices provides much better indicia of comparative advantage than in the case of a NME.<sup>451</sup>

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<sup>449</sup> As the major users of anti-dumping measure, the US, India and the EU employ the similar NME methodology in general except certain difference in the calculation approach and term definition. For example, the US has established a detailed definition of NME while the EU simply issues a list of countries without elaborating the selection criteria.

<sup>450</sup> Sebastina Farr, 'Individual treatment for exporters in anti-dumping cases: the China syndrome', *International Trade Law and Regulation*, (1997) 3, 105-107.

<sup>451</sup> Kenneth W. Dam, n.11, p.318-319.

Insofar as the export price and the dumping margin are concerned, Article 2.4.2 of the ADA provides that the dumping margin of each exporter shall be established on the basis of a comparison of a weighted average normal value with a weighted average of prices of all comparable export transactions or by a comparison of normal value and export prices on a transaction-to-transaction basis. Following either approach, the dumping margin in a market economy is calculated on an individual basis and the outcome would thus vary from one exporter to another. Consequently, the anti-dumping duty to be imposed has to be specified for each individual exporter respectively.

In contrast, no prices from the NME exporters will be taken into account individually. Rather, one weighted average price throughout the NME market is calculated, which will be later used in comparison with the normal value from the analogue country. Therefore, most NME investigations will arrive at one single dumping margin, as well as a unified level of anti-dumping duty for all the exporters therein. This is the one country-one duty principle. This principle derives from the assumption that all the means of production and natural resources in the NME belong to one entity of the state, which thus renders it impossible to make the distinction among individual producers. For this reason, all imports from the NME are considered to emanate from a single producer, and the application of a single rate is thus necessary to avoid circumvention of the duty, channelling of exports through the exporter with the lower duty rate.<sup>452</sup>

### **1.3.2 A methodology with varieties**

In terms of the NME methodology envisaged at the GATT/WTO, the prevailing practice combining the analogue approach and the one country-one duty principle is by no means the only or the exclusive choice of the importing Members. Instead, it should be considered as an extreme, or the most deviating, option in the anti-dumping investigation. Indeed, depending on the specific situations in different industries or sectors, an approach based on a rigid dichotomy resorting wholly to either domestic NME prices or analogue prices cannot be appropriate; rather, those that capture the element of continuum

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<sup>452</sup> Yuhan Liu, 'Anti-dumping measures and China', *Journal of Financial Crime*, (2005) 12, 272-289.

between the two polar approaches should be adopted.<sup>453</sup> In particular, at that point in time when such a NME country becomes truly a “market system”, obviously the special methodology should no longer be invoked. Up until that point, if individual sectors under investigation achieve sufficient “market orientation”, they could be eligible, on an individual basis, for the full regular GATT treatment instead of the NME treatment.<sup>454</sup> As the national economic reform progresses, it is not necessary, or even fair, to maintain the unchangeable practice ignoring data from the targeted NME. For example, in certain industries of China, although not all the MECs have been fully met, the market force has nevertheless been the major determinant in sector development. In this case, the traditional methodology should no longer apply; and instead, a variant of the current approach adapted to the particular features of the sector in question would be more suitable and effective.

For the calculation of normal value, substitute methods may refer to those stipulated under Article 2.2 of the ADA: a comparable price of the like product when exported to an appropriate third country, or the cost of production in China plus a reasonable amount for administrative, selling and general costs and for profits. With regard to export price, it is proposed that a weighted average value could be replaced by the individual price where the export activity could be proved to be independent from state interference in the NME.<sup>455</sup>

### **1.3.3 A methodology with substantial national discretion**

Another point regarding the NME methodology concerns the substantial discretion accorded to the importing Member. Due to the brief and generic-drafted instructions under the WTO agreements, importing Members in fact enjoy significant policy discretion in developing and establishing their own investigating approaches towards NMEs. This discretion has been mainly reflected in the definition of the NME and the criteria in the selection of the analogue country. Neither of the issues is standardised under the WTO and is thus exclusively subject to national decisions. The question then arises as to

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<sup>453</sup> Changho Sohn, n.24, p.782.

<sup>454</sup> John H. Jackson, n.10, p.332.

<sup>455</sup> Individual treatment under the EU anti-dumping regime is one typical example. For detailed discussion, see Chapter IV Section 1.3.

whether there should be outer limits circumscribing such discretion, or whether WTO Members are indeed entrusted with absolute autonomy to adopt any approach it considers suitable.

In this regard, the Working Party Report indicates only one prerequisite, according to which “when determining price comparability in a particular case in a manner not based on strict comparison with domestic prices or costs in China, the importing WTO Member should ensure that it had established and published in advance”.<sup>456</sup> However, it would be far-fetched to view this provision as the only precondition upon the NME treatment towards China. As analysed earlier, the WTO anti-dumping disciplines, namely, Article VI GATT and the ADA, constitute the general background against which Section 15 was negotiated and concluded; thus, obligations arising from such disciplines should equally apply to the NME methodology. Among others, the requirement for fair comparison is one of the fundamental parameters underlying the anti-dumping investigation. This requirement is of particular importance under the current NME practice since, from many aspects, the variant approach in calculation and comparison thereunder calls for the redefinition of this requirement.

According to Article 2.4 of the ADA, a fair comparison shall be made between the export price and the normal value, which shall be made at the same level of trade, normally at the ex-factory level, and in respect of sales made at, as nearly as possible, the same time. Furthermore, due allowance shall be made for differences which affect price comparability, including differences in conditions and terms of sale, taxation, levels of trade, quantities, physical characteristics, and any other differences which are also demonstrated to affect price comparability.<sup>457</sup>

In the context of NME, first of all, the principle of fair comparison mainly concerns the selection and adjustment of the normal value and the export price to make sure they are compared at the same stage. Second, under the analogue country approach, this requirement further highlights the adjustments regarding the different economic conditions between the reference country of market

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<sup>456</sup> Para 151 (a) Working Party Report.

<sup>457</sup> Articles 2.4 ADA.

economy and the NME under investigation. In other words, there is a similar broad concept of whether the market situation in the analogue country would prevent such a fair comparison as required under the ADA; in spite of the existence of some vagueness about when a comparison is proper, it appears to set a minimum objective standard.<sup>458</sup>

For a long time, the analogue country approach has been criticised for its blindness to the comparative advantages, especially the cost advantages, enjoyed by the NMEs.<sup>459</sup> In most cases, data from the analogue country is appreciated with higher costs than the NME concerned and as a result, the latter country would naturally be found to have been dumping. Furthermore, a fear also exists that this approach leads to higher dumping margins caused by a higher normal value owing to the different development levels between the two countries.<sup>460</sup>

With regard to China's case, there are many ramifications and potential unfairness inherent in the analogue country test, which apparently denies all of the most obvious advantages enjoyed by the Chinese producers, such as access to natural resources and low-priced labour.<sup>461</sup> Moreover, due to the transition process towards a market economy, most industries in China nowadays possess characteristics of both NME and market economy. It thus appears impossible for a selected analogue country with full market economic conditions to accurately reflect the situation of its counterparts in China.

Therefore, there is an inherent limitation, or incapacity, on the part of any surrogate country to capture and demonstrate all the market characteristics of the NME concerned,<sup>462</sup> and thus, reasonable allowance and adjustments become necessary and indispensable in the investigation. Put in another way, if the normal value, based on the data from an analogue country, is not capable of reflecting the situation in the actual exporting NME supplier, the resulting price

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<sup>458</sup> Michael Lennard, 'Interpreting China's Accession Protocol: a case study in anti-dumping', in Deborah Cass, Brett Williams and George Barker (eds), *China and the World Trading System: Entering the New Millennium*, Cambridge University Press, 2003.

<sup>459</sup> Tine W.A.J. Delva, 'What happens when the dragon storms the fortress? China's unique position in EU policy on trade defence instruments', *International Trade Law and Regulation*, (2007) 13, 19-29.

<sup>460</sup> Ibid.

<sup>461</sup> Yuhan Liu, n.40.

<sup>462</sup> Changho Sohn, n.24, p.782.

difference could by no means be considered as a proof of the dumping practice on the part of the NME, since there cannot exist a price in the first place.<sup>463</sup> Therefore, a normal value with a general mirroring effect is a compulsory starting point among all other concrete evidence for dumping practice. Therefore, in the context of Section 15, the investigating authorities are under the obligation to make sure that data from the analogue country, with or without adjustment, is able to represent, to the maximum extent possible, the situation in the corresponding Chinese market and industries.

#### **1.4 Summary remarks**

Based on the foregoing analysis, the most significant feature of the transitional anti-dumping mechanism under Section 15 is the abstract content thereof, as well as the consequent discretion granted to national autonomy. In terms of linguistic accuracy, provisions under Section 15 are too vague and general to result in any substantial legal framework. Most issues related to the regime envisaged thereunder are unspecified; there are thus barely any obligations on the part of duty-imposing countries arising directly from the accession documents. As a result, provisions under Article VI GATT and the ADA become the only WTO benchmark that might be used to assess the legality of the NME treatment. Even if their application were excluded in the case of normative conflict with Section 15, such provisions nevertheless constitute essential guidance for most of the issues, if not all, during the investigation and application stages.

The most prevailing NME practice at the current stage, in particular, the methodology consisting of the analogue country approach and one country–one duty principle, is not without controversy. Chapter IV will develop detailed exploration of this practice under EU’s import regime.<sup>464</sup> Here, suffice it to say, in general, this methodology does not turn out to be an approach with sufficient economic justification. More important, the permissive national discretion granted thereunder further gives rise to the risk of biased and abusive use of the contingency instrument of anti-dumping.

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<sup>463</sup> It is argued that for an accurate price under the analogue approach, certain adjustments to the data collected from the third country are required. For detailed discussion, see Chapter IV Section 1.1.1.

<sup>464</sup> For detailed discussion, see Chapter IV Section I.

## ***Section II. Section 16 of the Accession Protocol: the transitional product-specific safeguard mechanism***

Section 16 of the Accession Protocol establishes a transitional product-specific safeguard mechanism exclusively applied to industrial products of Chinese origin. The question first arises as to whether the establishment of this China-only mechanism excludes the applicability of the general WTO safeguards under Article XIX GATT and the SGA. This has been clearly answered in Section 16.1, according to which during the consultation between China and the affected WTO Member, it should be first decided whether the WTO Member should pursue application of a measure under the Agreement on Safeguards.<sup>465</sup> It thus becomes clear that insofar as imports from China are concerned, the choice of measures between the SGA and Section 16 is up to the decision of the protection-affording Member.

The co-applicability and compatibility of these two mechanisms have been tested in practice. On 11 July 2003, the European Commission initiated a safeguard investigation on the imported citrus fruits from all sources on the basis of both Section 16 and the SGA. On 8 November 2003, the Commission imposed the provisional measures under Article 6 SGA but in contrast, no separate actions were taken under Section 16. In fact, the Commission decided to terminate the application of this China-specific mechanism on the grounds that sufficient protection for the Community industry can be expected from the general WTO system and therefore it is not in the Community interest to continue with two proceedings, which are different in their conditions and their possible outcome.<sup>466</sup>

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<sup>465</sup> Section 16.1 provides “in cases where products of Chinese origin are being imported into the territory of any WTO Member in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of like or directly competitive products, the WTO Member so affected may request consultations with China with a view to seeking a mutually satisfactory solution, including whether the affected WTO Member should pursue application of a measure under the Agreement on Safeguards”.

<sup>466</sup> 2003/855/EC: Commission Decision terminating the transitional product-specific safeguard proceeding concerning imports of certain prepared or preserved citrus fruits (namely mandarins, etc.) originating in the People's Republic of China, OJ, L 323, 10/12/2003, p. 11-12.

In other words, the Commission repealed the operation of the transitional safeguards by the general WTO mechanism and thus citrus fruits from China were subject to the same restrictions as imports from other sources.

Under Section 16, two types of action are established, namely, the market disruption safeguards and the trade diversion safeguards. These two actions are designated to defend interests of different importing groups. While the market disruption safeguards focus on the direct destinations of the targeted imports, the trade diversion safeguards provide extra-protection for the third countries importing the same products but not the original and direct destinations of the consignments from China. Detailed analysis of both instruments will be developed later; here, suffice it to say that the same Chinese products, subject to market disruption restrictions, may simultaneously be restricted by trade diversion actions by multiple WTO Members.<sup>467</sup> It is nevertheless worth mentioning that first, no similar measures against trade diversion are provided under the standard WTO safeguards; and as for the market disruption safeguards, although built on similar rationales as those under the SGA, they are noticeably characterised, or distinguished, by the features of selective application, longer “tolerance period” for compensation and the potential use of VERs.

### **2.1 Market disruption safeguards**

According to Section 16, in the case of market disruption or threat thereof, the affected Member may request consultations with China to seek a mutually satisfactory solution. If it is agreed that action is necessary, China shall take such action to prevent or remedy the market disruption. If no agreement is reached within 60 days, the affected Member shall be free to either withdraw concessions or limit imports to the necessary extent. As mentioned above, such safeguards are in general based on the same rationale as the standard WTO mechanism serving as a safety valve against unexpected import surges. However, in terms of the investigation and the enforcement process, a number of discrepancies between these two devices can nevertheless be identified.

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<sup>467</sup> Scott Andersen and Christian Lau, ‘Hedging hopes with fears in China’s accession to the WTO: the transitional special-product safeguard for Chinese exports’, *Journal of World Intellectual Property*, (2002) 5, 405-476, p.407.

The most blatant discrepancy lies in the non-application of the MFN principle, which is indeed regarded as the common character of contemporary safeguards, as well as the major reason why economists typically prefer safeguards to other contingency measures. In particular, the requirement for non-discrimination among exporting countries avoids the potential efficiency losses from trade diversion that occur when protection-affording countries discriminate between foreign exporters of the same product and shift imports from low-cost products to less-efficient exporters.<sup>468</sup> In contrast, Section 16 essentially follows the discriminatory application and is targeted exclusively at imports from China. As will be analysed in the coming part, such discrimination will become even more noticeable when imports from all sources are increasing at the same time. For instance, in the case of market injury, which is “material” in nature but has not reached the “serious” degree, Section 16 would allow the WTO Member to place restrictions on the particular products of Chinese origin while simultaneously importing the same products from other Members without restrictions.

### **2.1.1 Substantive thresholds of market disruption and the compulsory procedures in the implementation**

Under the transitional mechanism of Section 16, market disruption is defined as the primary substantive threshold to impose a safeguard restriction. Section 16.4 explains this term as follows: “market disruption shall exist whenever imports of an article, like or directly competitive with an article produced by the domestic industry, are increasing rapidly, either absolutely or relatively, so as to be a significant cause of material injury, or threat of material injury to the domestic industry”. It thus becomes clear that market disruption is based on the existence of material injury or the threat thereof caused in the importing market. This substantive threshold is in notable contrast with the SGA, which raises the benchmark and mandates “serious injury” instead. The ensuing section will examine three essential elements under the term “market disruption”, namely, the concept of “like or directly competitive products”, “material injury” and the causal link as “a significant cause”.

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<sup>468</sup> Chad P. Bown, ‘Why are safeguards under the WTO so unpopular?’, *World Trade Review*, (2002) 1, 47-62, p.50.

*The concept of “like or directly competitive products”*

The determination of the term “like or directly competitive products” has long been a controversial issue. It is mainly because this term has been widely used in different WTO agreements. Within the GATT, it is included in Article I on MFN, Article III on national treatment, Article VI on anti-dumping and Article XIX on safeguards. In the area of contingent trade protection, such as anti-dumping and safeguards, defining the category of this term is a critical preliminary step closely linked to several investigating issues, i.e. the injury test and the sample selection, which will also determine the scope of the measure to be imposed.

However, neither the SGA nor Section 16 has provided sufficient elaboration of this concept; recourse thus has to be made to relevant WTO jurisprudence. In this regard, the Appellate Body first pointed out, in *Japan – Alcohol Beverages*, that the scope and meaning of the same term are different under those occasions.<sup>469</sup> However, the question was left open as to how the different definitions of this term should vary from clause to clause, and how is it possible for interpretations of the same clause to be different on a case-by-case basis.<sup>470</sup> On the one hand, among WTO disputes on various subject matters, one must be cautious in drawing inferences from cases in other issue areas. On the other hand, where specific guidelines cannot be found in safeguards, the cases from other issue areas could at least provide a useful starting point.<sup>471</sup>

Therefore, the following analysis will first seek for assistance from the jurisprudence on safeguard actions. However, owing to the limited number of disputes in this area, reference will also be made to those concerning national treatment. One reason for this methodology is that in both areas, comparison is to be made between a category of imported goods and a category of domestic goods of the importing country, whereas under other circumstances, categories from other sources, i.e. imported goods from another third country, are also

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<sup>469</sup> Won-Mog Choi, *“Like products” in International Trade Law: towards a Consistent GATT/WTO Jurisprudence*, Oxford University Press, 2003, p.91.

<sup>470</sup> Ibid.

<sup>471</sup> Alan O. Sykes, *The WTO Agreement on Safeguards: a Commentary*, Oxford University Press, 2006, p. 139-140.

involved.<sup>472</sup> This interpretative link was confirmed in *US-Cotton Yarn*, a dispute concerning the ATC safeguard measure imposed by the US. The panel in that case considered that the interpretation of the term “directly competitive and substitutable products” under Article III GATT is relevant in interpreting the term “directly competitive products” under Article 6 ATC.<sup>473</sup> The Appellate Body in the appeal also shed light on this issue, which ruled “we do not consider that the mere absence of the word ‘substitutable’ in Article 6.2 ATC renders our interpretation under Article III GATT irrelevant in terms of its contextual significance”.<sup>474</sup>

With regard to “like products”, as pointed out by the Appellate Body, there can be no precise and absolute definition of what is “like”. The kind of evidence to be examined in assessing the ‘likeness’ of products will, necessarily, depend upon the particular products and the legal provisions being dealt with.<sup>475</sup> In *EC — Asbestos*, the Appellate Body referred to the Report of the Working Party on *Border Tax Adjustment* and confirmed that the criteria listed in this Report provided a framework for analysing the “likeness” of products. In particular, it comprises four categories of “characteristics” that the products involved might share: (i) the physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end-uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes.<sup>476</sup> In sum, the likeness determination should depend upon a “balanced” examination of the three objective elements, namely, physical properties, tariff classification and end-use in general. The reliance on the tariff nomenclature has been nonetheless criticised from the economic point of view because it covers a much too wide universe of products.<sup>477</sup>

It is further highlighted by the Appellate Body that these criteria were not drawn

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<sup>472</sup> Won-Mog Choi, n.57, p.91.

<sup>473</sup> *US- Cotton Yarn*, Panel Report, WT/DS192/R, para 7.46.

<sup>474</sup> *US-Cotton Yarn*, Appellate Body Report, WT/DS192/AB/R, para 94.

<sup>475</sup> *Japan—Alcoholic*, Appellate Body Report, WT/DS8/AB/R, para 114; *EC — Asbestos*, Appellate Body Report, WT/DS135/AB/R, para 103.

<sup>476</sup> *EC — Asbestos*, Appellate Body Report, n.60, paras 101-103.

<sup>477</sup> Petros C. Mavroidis, Patrick A. Messerlin, Jasper M. Wauters, *The Law and Economics of Contingent Protection in the WTO*, Edward Elgar Publishing Ltd, 2008, p. 21.

from the treaty nor did they constitute a “closed list” that will determine the legal characterisation of products.<sup>478</sup> That is to say, the adoption of a particular framework to aid the examination of evidence does not dissolve the duty or the need to examine, in each case, all of the pertinent evidence. Instead, the “likeness” of particular products should be analysed on a case-by-case basis and these criteria are simply tools to assist in the task of sorting and examining the relevant evidence.<sup>479</sup> The similar position was repeated later in *Japan—Alcoholic Beverages* involving internal tax discrimination.

Furthermore, in *US-Lamb Meat*, which is concerned with a definitive safeguard measure imposed by the US against lamb meat from Australia and New Zealand, the panel held that “like products would mean the like end-products”; and in that case, the panel considered that the feeders and growers of live lambs were thus not included in the domestic industry.<sup>480</sup>

With regard to the term of “directly competitive products”, more clarifications could be found in the context of safeguards, such as the *US-Cotton Yarn* dispute, where Pakistan lodged a complaint in respect of an ATC transitional safeguard measure on combed cotton yarn applied by the US. In that case, the Appellate Body first explained the function of this term as follows: a plain reading of the phrase “domestic industry producing like and/or directly competitive products” shows clearly that the terms “like” and “directly competitive” are characteristics attached to the domestic products that are to be compared with the imported product.<sup>481</sup> This is thus a criterion aiming to ensure that the domestic industry is the appropriate industry in relation to the product under investigation; and the degree of proximity between the imported and domestic products in their competitive relationship is thus critical to underpin the reasonableness of a safeguard action.<sup>482</sup>

According to the Appellate Body, two products are in a competitive relationship if they are commercially interchangeable or if they offer alternative ways of

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<sup>478</sup> *EC — Asbestos*, Appellate Body Report, n.60, paras. 101-103.

<sup>479</sup> *Ibid.*

<sup>480</sup> *US-Lamb*, Panel Report, WT/DS177/R, WT/DS/178/R, para. 7.109.

<sup>481</sup> *US-Cotton Yarn*, Appellate Body Report, n.62, para. 86.

<sup>482</sup> *Ibid.*, para. 95.

satisfying the same consumer demand in the marketplace.<sup>483</sup> Two issues are affiliated to this definition. First of all, "competitive" is a characteristic attached to a product and denotes the capacity of a product to compete both in a current or a future situation.<sup>484</sup> The word "competitive" indeed has a wider connotation than "actually competing" and includes also the notion of a potential to compete. It is therefore not necessary that two products be competing, or that they be in actual competition with each other, in the marketplace at a given moment in order for those products to be regarded as competitive.<sup>485</sup> A static view in this regard is incorrect.

Second, the Appellate Body also opined that it is significant that the word "competitive" is qualified by the word "directly", which emphasises the degree of proximity that must obtain in the competitive relationship between the products under comparison.<sup>486</sup> It is because in order to ensure that the protection afforded by a particular safeguard action is reasonable, the domestic industry under comparison must be at least producing "directly" competitive products.

A comparison between the "like" and the "directly competitive" products was also drawn in that case. In terms of the competitive relationship, "like products" are, necessarily, in the highest degree in the marketplace.<sup>487</sup> In permitting a safeguard action, the first consideration is, therefore, whether the domestic industry is producing a like product as compared with the imported product in question. If this is so, there can be no doubt as to the reasonableness of the safeguard action against the imported product.<sup>488</sup> It is only when the product produced by the domestic industry is not a "like product" as compared with the imported product, the question arises of how close the competitive relationship between them should be. It is common knowledge that unlike or dissimilar products can also compete in the marketplace, although to varying degrees ranging from direct or close competition to remote or indirect competition. The term "competitive" has, therefore, purposely been qualified and limited by the

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<sup>483</sup> Ibid, para. 96.

<sup>484</sup> Ibid.

<sup>485</sup> Ibid.

<sup>486</sup> Ibid, para. 97.

<sup>487</sup> *Korea – Alcoholic Beverages*, Appellate Body Report, WT/DS75/AB/R, WT/DS84/AB/R, para. 118; *Canada – Certain Measures Concerning Periodicals*, Appellate Body Report, WT/DS31/AB/R, para. 473.

<sup>488</sup> *US-Cotton Yarn*, Appellate Body Report, n.62, para. 97.

word "directly" to signify the degree of proximity that must obtain in the competitive relationship when the products in question are unlike.<sup>489</sup> Put in another way, under this definition of "directly", a safeguard action will not extend to protecting a domestic industry that produces unlike products, which have only a remote or tenuous competitive relationship with the imported product.<sup>490</sup>

In sum, on the one hand, the term "like products" requires similarity in the physical characteristics and in the end-usage of the products under investigation. On the other hand, the concept of "directly competitive products" further allows the inclusion of certain products that do not bear any physical similarity in the ambit of domestic products, provided that there is a degree of market competition between them, which is usually demonstrated by the close commercial relationship and a degree of substitutability.<sup>491</sup> With regard to the application of such concepts under Section 16, the importing WTO Member has to first prove the existence of a domestic industry producing products, which could qualify as the "like or directly competitive products" of the Chinese exports in question. Furthermore, it also circumscribes the scope of the subsequent investigation on material injury and causal link, which will be analysed in the coming sections.

### ***Material injury***

According to Section 16.4, market disruption can be proved only on the basis of material injury caused to the domestic industry of the importing Member. The investigating authorities are therefore under an obligation to prove the existence of material injury or at least the threat thereof in the preliminary investigation.

Indeed, the term "material injury" is not new to the WTO, which is widely used in the so-called unfair trade investigation, i.e. dumping sales. Under the ADA, the determination of injury is stipulated in Article 3, which sets forth the substantive obligation in the injury investigation and the general guidance in this process. It is provided that "a determination of injury for purposes of [Article VI](#)

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<sup>489</sup> Ibid, para. 98.

<sup>490</sup> Ibid.

<sup>491</sup> Yong-Shik Lee, *Safeguard Measures in World Trade: the Legal Analysis*, Kluwer Law International, 2003, p.126.

[of GATT 1994](#) shall be based on positive evidence and involve an objective examination of both (a) the volume of the dumped imports and the effect of the dumped imports on prices in the domestic market for like products, and (b) the consequent impact of these imports on domestic producers of such products”.

As the Appellate Body pointed out in *US — Hot-Rolled Steel*, “the thrust of the investigating authorities’ obligation, in [Article 3.1](#), lies in the requirement that they base their determination on ‘positive evidence’ and conduct an ‘objective examination’”.<sup>492</sup> Following the general requirements for positive evidence and objective examination, Article 3.1 further specifies three particular factors to be assessed, namely, the increased import volume, the effect caused on prices, and the impact resulted in domestic industry.

According to the Appellate Body, “the term ‘positive evidence’ relates, in our view, to the quality of the evidence that authorities may rely upon in making a determination... the word ‘positive’ means, to us, that the evidence must be of an affirmative, objective and verifiable character, and that it must be credible.”<sup>493</sup> Furthermore, in *Thailand — H-Beams*, the Appellate Body reversed the Panel’s finding that an injury determination must be based only upon evidence disclosed to, or discernible by, the parties to the investigation; instead, it is concluded that “[Article 3.1](#) ... permits an investigating authority making an injury determination to base its determination on all relevant reasoning and facts before it.”<sup>494</sup> Therefore, an injury determination conducted pursuant to Article 3 ADA must be established on the totality of the evidence, which should not be limited only to those submitted by the parties under the investigation.

The Appellate Body, in *US — Hot-Rolled Steel*, analysed the term of “objective assessment” through drawing a comparison with “positive evidence”. In particular, it is observed that, while “positive evidence” focuses on the facts underpinning and justifying the injury determination, “objective examination” is concerned with the investigative process itself. According to the Appellate Body, the word “examination” relates to the way in which the evidence is gathered, inquired into and, subsequently, evaluated; that is, it relates to the conduct of the

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<sup>492</sup> *US — Hot-Rolled Steel*, Appellate Body Report, WT/DS184/AB/R, para. 192.

<sup>493</sup> *Ibid.*

<sup>494</sup> *Thailand — H-Beams*, Appellate Body Report, WT/DS122/AB/R, para. 111.

investigation generally.<sup>495</sup> Furthermore, the word “objective”, which qualifies the word “examination”, indicates essentially that the “examination” process must conform to the dictates of the basic principles of good faith and fundamental fairness.<sup>496</sup> In short, an “objective examination” requires that the domestic industry, and the effects of dumped imports, be investigated in an unbiased manner, without favouring the interests of any interested party, or group of interested parties, in the investigation.<sup>497</sup>

For the three parameters under the injury test, Article 3.2 first requires the investigating authorities to consider whether there has been a significant increase in dumped imports, either in absolute terms or relative to production or consumption in the importing Member. In *Thailand — H-Beams*, the panel considered that [Article 3.2](#) does not require that the term “significant” be used to characterise a subject increase in imports in the determination of an investigating authority.<sup>498</sup> Based on the dictionary meaning of the word “consider”, the panel did not believe [Article 3.2](#) requires an explicit “finding” or “determination” by the investigating authorities as to whether the increase in dumped imports is “significant”.<sup>499</sup> On the one hand, the word “significant” does not necessarily need to appear in the text of the relevant document in order for the Article 3.2 requirements to be fulfilled. On the other hand, however, there must be evidence in the documents showing that the investigating authorities have given attention to and taken into account whether such increase in dumped imports indeed existed.

Second, as to the effect of the dumped imports on prices, according to Article 3.2, it should be demonstrated by either a significant price undercutting in the domestic market or a significant price depression where the price would otherwise increase.

Third, for the last element regarding the impact upon domestic industries, Article 3.4 mandates the assessment of domestic production through evaluating all

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<sup>495</sup> [US — Hot-Rolled Steel](#), Appellate Body Report, n.80, para. 193.

<sup>496</sup> Ibid.

<sup>497</sup> Ibid.

<sup>498</sup> [Thailand — H-Beams](#), Panel Report, WT/DS122/R, para. 7.161.

<sup>499</sup> Ibid.

relevant economic factors and indices having a bearing on the state of the industry. In particular, the investigation authorities shall look into actual and potential decline in sales, profits, output, market share, productivity, return on investments, or utilisation of capacity; factors affecting domestic prices; the magnitude of the margin of dumping; actual and potential negative effects on cash flow, inventories, employment, wages, growth, and the ability to raise capital or investments. Furthermore, it is also noted that this list is not exhaustive, nor can one or several of these factors necessarily give decisive guidance.<sup>500</sup>

With regard to the total 15 economic factors nominated under Article 3.4 ADA, an issue that has come up repeatedly in the WTO dispute settlement proceedings is whether the listed injury factors must be evaluated in each and every case and whether the evaluation must be apparent in the final determination.<sup>501</sup> As the panel on *EC — Bed Linen* considered, “the use of the phrase ‘shall include’ in [Article 3.4](#) strongly suggests to us that the evaluation of the listed factors in that provision is properly interpreted as mandatory in all cases. That is, in our view, the ordinary meaning of the provision is that the examination of the impact of dumped imports must include an evaluation of all the listed factors in [Article 3.4](#)”.<sup>502</sup> The Appellate Body reiterated the same position in *Thailand — H-Beams*, according to which Article 3.4 left no doubt that all 15 factors have to be assessed in the investigation.<sup>503</sup>

However, the relevance of these factors in the pending investigation is another issue. In *Mexico — Corn Syrup*, the panel, while confirming the mandatory nature of the list, nevertheless indicated that “such consideration may lead the investigating authority to conclude that a particular factor is not probative in the circumstances of a particular industry or a particular case, and therefore is not relevant to the actual determination”.<sup>504</sup> Therefore, even if the assessment of each factor must be apparent in the final determination and the investigating authorities are under the obligation to explain why a particular factor is not

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<sup>500</sup> Article 3.4 ADA.

<sup>501</sup> Edwin Vermulst, *The WTO Anti-Dumping Agreement: a Commentary*, Oxford University Press, 2005, p.87.

<sup>502</sup> *EC — Bed Linen*, Panel Report, WT/DS141/R, paras. 6.154–6.159.

<sup>503</sup> *Thailand — H-Beams*, Appellate Body Report, n.82, para. 125.

<sup>504</sup> *Mexico — Corn Syrup*, Panel Report, WT/DS132/R, para. 7.128.

relevant in the pending case, the requirement for comprehensive evaluation does not mean that all the listed factors have to indicate a negative trend.

The final issue to be discussed under the injury test of the transitional safeguards is the different substantive threshold thereunder compared with the one under the SGA. Under the standard WTO safeguards, “serious injury” caused by the import surge to the domestic industry is required as the indispensable trigger for action,<sup>505</sup> which, according to Article 4.1 SGA, shall be understood to mean a significant overall impairment in the position of a domestic industry. Article 4.2 SGA further provides for the competent authorities a list of factors to be examined in the injury test.<sup>506</sup>

It has to be pointed out that the degree of damage required for material injury is generally considered less than that of serious injury. As the Appellate Body confirmed in *US – Lamb*, “we are fortified in our view that the standard of serious injury in the Agreement on Safeguards is a very high one when we contrast this standard with the standard of material injury envisaged under the Anti-Dumping Agreement, the Agreement on Subsidies and Countervailing Measures and GATT 1994”.<sup>507</sup> Therefore, the question arises as to the choice of the material injury test, which is normally used against unfair trade practice, under a safeguard device against innocent import surge. It is highly questionable to apply transitional safeguard measures based on anything less than serious injury, since such measures are only an emergency device of last resort to relieve the domestic economy of an acute economic and political shock from the rapid decline of the domestic industry caused by an increase in imports.<sup>508</sup>

***Causal link: a significant cause***

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<sup>505</sup> Article 2 SGA.

<sup>506</sup> Article 4.2 SGA provides “in the investigation to determine whether increased imports have caused or are threatening to cause serious injury to a domestic industry under the terms of this Agreement, the competent authorities shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry, in particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment”.

<sup>507</sup> “Material injury” is required under Article VI GATT, Articles 5 and 15 of the SCM Agreement, and Article 3 of the ADA.

<sup>508</sup> Yong-Shik Lee, n.79, p.126.

The causal link required under Section 16 indicates that the increase in imports from China has to be a significant cause of the material injury, or the threat thereof in the importing market. However, it is still unclear from the text what the meaning is of “a significant cause” in this context. Indeed, a reference for the definition of this phrase cannot be found in other WTO agreements but some WTO jurisprudence.

First of all, “a significant cause” implies a close temporal connection between the arrival and increase in volume of Chinese imports and the injury to the domestic industry of the importing country. This is the so-called “correlation approach” in the causation analysis, which indicates that an increase in imports should normally coincide with a decline in the relevant injury factors.<sup>509</sup> This approach was confirmed in *Argentina – Footwear*, where the Appellate Body considered, after verifying the panel's interpretation of the causation requirements, that “we will consider whether Argentina's causation analysis meets these requirements on the basis of (i) whether an upward trend in imports coincides with downward trends in the injury factors, and if not, whether a reasoned explanation is provided as to why nevertheless the data show causation”.<sup>510</sup>

Second, the use of *a* significant cause rather than *the* significant cause suggests that the Chinese imports in question do not have to be the only reason for the material injury caused (emphasis added). Other factors contributing to the material injury in the domestic industry could be involved at the same time, such as non-Chinese imports or non-import factors.<sup>511</sup> In *US – Wheat Gluten*, the Appellate Body rejected the panel's conclusion that the serious injury must be caused by the increased imports alone and that the increased imports had to be sufficient to cause “serious injury”. It was concluded that “the need to distinguish between the effects caused by increased imports and the effects caused by other factors does not necessarily imply, as the panel said, that increased imports on their own must be capable of causing serious injury, nor that injury caused by other factors must be excluded from the determination of serious injury”.<sup>512</sup> This proposition was raised again by the Appellate Body in *US – Lamb*, where it

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<sup>509</sup> Alan O. Sykes, ‘The safeguard mess: a critique of WTO jurisprudence’, *World Trade Review*, (2003) 2, 261-295, p. 280.

<sup>510</sup> *Argentina – Footwear*, Appellate Body Report, n.32, paras. 141 and 144.

<sup>511</sup> Scott Andersen and Christian Lau, n.55, p.423.

<sup>512</sup> *US - Wheat Gluten*, Appellate Body Report, WT/DS166/AB/R, para. 70.

stated that “the Agreement on Safeguards does not require that increased imports be ‘sufficient’ to cause, or threaten to cause, serious injury. Nor does that Agreement require that increased imports alone be capable of causing, or threatening to cause, serious injury”.<sup>513</sup>

### *Compulsory procedural obligations*

The procedures to be followed by the investigating authorities are laid down in Section 16.5 of the Accession Protocol and further elaborated in Para 246 of the Working Party Report. During the negotiation process, the representative of China expressed particular concern over whether the importing Members provide due process and use objective criteria in determining the existence of market disruption. The lack of most Members’ experience in implementing similar provisions as those under Section 16 was at the root of this concern.<sup>514</sup> Hence, it is agreed under Para 246 on detailed procedural obligations on the part of importing Members. Few discrepancies, if any, could be identified between Para 246, on the one hand, and Article 3 SGA on the preliminary investigation, on the other, except the provisions concerning the protection of confidential information in the latter.<sup>515</sup>

However, one significant step highlighted in the SGA is missing under the transitional safeguards, namely, the non-attribution test. The tenet of this test is summarised in Article 4.2 SGA, which stipulates that “in the investigation to determine whether increased imports have caused or are threatening to cause serious injury to a domestic industry, the competent authorities shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry...when factors other than increased imports are causing injury to the domestic industry at the same time, such injury shall not be attributed to increased imports”.

Therefore, it is not necessary for the import surges under investigation to be the only cause of serious injury insofar as they have played a part in, or clearly contributed to, bringing about the injury. In *Argentina — Footwear*, the panel

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<sup>513</sup> *US - Lamb*, Appellate Body Report, WT/DS178/AB/R, para. 170.

<sup>514</sup> Section 13 Working Party Report.

<sup>515</sup> Article 3.2 SGA.

recognised the necessity of a sufficient consideration of “other factors” under [Article 4.2\(b\)](#) and considered that, as part of the causation analysis, any injury caused by such other factors should be identified and properly attributed.<sup>516</sup> In *US — Wheat Gluten*, the Appellate Body confirmed this non-exclusive interpretation of the causal link. It ruled that “the language in the first sentence of [Article 4.2\(b\)](#) does not suggest that increased imports be the sole cause of the serious injury, or that ‘other factors’ causing injury must be excluded from the determination of serious injury. To the contrary, the language of [Article 4.2\(b\)](#), as a whole, suggests that ‘the causal link’ between increased imports and serious injury may exist, even though other factors also contribute, ‘at the same time’, to the situation of the domestic industry”.<sup>517</sup>

Moreover, the Appellate Body also stressed the importance of separating the injurious effects caused by increased imports from those caused by other factors. Based on its finding that increased imports need not to be the sole cause of serious injury, the Appellate Body, in *US — Wheat Gluten*, further referred to the “non-attribution” requirement in the last sentence of [Article 4.2\(b\)](#). “Clearly, the process of attributing ‘injury’, envisaged by this sentence, can only be made following a separation of the ‘injury’ that must then be properly ‘attributed’. What is important in this process is separating or distinguishing the effects caused by the different factors in bringing about the ‘injury’.”<sup>518</sup>

Following the above principles elaborated in the jurisprudence, a three-stage investigation was established in the non-attribution test. According to the Appellate Body, the first step concerns the injurious effects caused to the domestic industry by increased imports as distinguished from the injurious effects caused by other factors.<sup>519</sup> As a second step in their examination, the competent authorities then have to attribute ‘injury’ caused to increased imports, on the one hand, and, by implication, to other relevant factors, on the other hand.<sup>520</sup> Through these two stages, the competent authorities could thus ensure that any injury to the domestic industry that was actually caused by other factors

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<sup>516</sup> [Argentina – Footwear](#), Panel Report, WT/DS121/R, para. 8.267.

<sup>517</sup> *US - Wheat Gluten*, Appellate Body Report, n.100, para. 67.

<sup>518</sup> *Ibid*, para. 68.

<sup>519</sup> *Ibid*, paras. 69–70.

<sup>520</sup> *Ibid*.

is not ‘attributed’ to the import surges. In the final step, the competent authorities have to determine whether ‘the causal link’ exists between increased imports and serious injury, and whether this causal link involves a genuine and substantial relationship of cause and effect between these two elements.<sup>521</sup>

In sum, based on the relevant SGA provisions and WTO rulings, investigating authorities are under the procedural obligation to identify the nature and extent of the injurious effects of the known factors other than increased imports, separate and distinguish these effects accordingly, and establish explicitly, with a reasoned and adequate explanation, that they have been disentangled from the injurious effects caused by import surges. In this way, the final determination rests properly on the genuine and substantial relationship of cause and effect between increased imports and serious injury.<sup>522</sup>

Once again, due to the cumulative application of WTO rules, this test should be tenably maintained under the transitional safeguards, even in the absence of express provisions in this regard. Indeed, market disruption, as well as trade diversion, in the context of Section 16 is in most cases the joint effect of a series of factors, including not only imports from different exporting countries but also other non-import elements, such as inflation, supply problems and consumer demands. The selective application of transitional safeguards further highlighted the necessity of such test. As mentioned earlier, Section 16 allows for restraints to be imposed on particular products from China while the same products from other Members enjoy free trade. In particular, this is the case where domestic injury caused by the import increase from other sources has reached the “material” degree but not sufficiently “serious”. Under this circumstance, a comparative analysis should be carried out among all the WTO Members, the imports from which are to a varying extent responsible for the material injury caused even if they are not the targets of the pending safeguard action. In any event, the investigating authorities cannot simply ascribe all the damage suffered by domestic industries to the products from China if other elements also play a role in the market disruption. It would be unfair for China to take responsibility

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<sup>521</sup> Ibid.

<sup>522</sup> *US-Cotton Yarn*, Appellate Body Report, n.62; [Argentina – Footwear](#), Panel Report, n.104; [Argentina – Footwear](#), Appellate Body Report, n.32; *US - Wheat Gluten*, Appellate Body Report, n.100; *US - Lamb*, Appellate Body Report, n.101.

for all the damage caused and thus it is important to ensure that investigating authorities have excluded impact arising from other sources.

This comparative analysis is also essential in the light of the following issues. First, it could effectively prevent procedural abuse in the investigation process in that, by skipping this test, it would lead to a much easier burden of proof on the investigating authorities. It is because, in establishing a causal link between import surge and domestic material injury, investigating authorities might be able to focus solely on the causal link connected to the products from China without accounting for the contribution from other imports and non-import factors.<sup>523</sup> Furthermore, according to Section 16, both market disruption and trade diversion safeguards should be applied only to the extent, and maintained only for such period of time, necessary to prevent or remedy the market disruption caused. The form, extent and duration of the measure to be imposed under the transitional safeguards are thus primarily dependent on the injurious effect attributed to the increased imports from China. Therefore, for a safeguard action at a reasonable and fair level, the non-attribution test is highly required.

### **2.1.2 Application of the market disruption safeguards**

Apart from the lowered substantive threshold analysed above, Section 16 safeguards are further characterised by the revived use of VERs. As a widespread trade practice prior to the mid-1990s, VERs were usually negotiated and agreed upon under a bilateral arrangement between contracting parties but outside the GATT system. Generally speaking, their aim was to tackle the difficulties faced by certain industries in the importing country; and therefore the exporting country would be asked to agree on quantitative export limitations administered by either the exporting or importing side. Arrangements of this type were titled as “voluntary restraint agreements”, “voluntary export restraints” or “orderly marketing arrangement”,<sup>524</sup> which usually lasted for a fairly long time period. According to a GATT report, among the 249 arrangements in force as of late 1989, 36 were introduced prior to 1975 and another 39 between 1975 and

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<sup>523</sup> Scott Andersen and Christian Lau, n.55, p.430.

<sup>524</sup> Alan O. Sykes, n.59, p. 22.

1979.<sup>525</sup> Until early 1991, there were at least 284 known export restraint agreements maintaining in effect. However, it is widely accepted that VERs, as a typical grey-area measure, could undo much of what the GATT had accomplished in trade liberalisation; they are therefore condemned for having a distorting effect on world trade and for the lack of trade compensation for the exporting countries.<sup>526</sup>

The proliferation of VERs attracted considerable attention during the Uruguay Round negotiations. Developing Members under restrictions sought the termination of such trade instruments based on selective application and instead advocated the non-discriminatory application of trade restrictions. In response to the demand, negotiation on a new safeguard agreement was initiated, which eventually led to the conclusion of the SGA as an essential part of the WTO package. In its preamble, the SGA confirms the aim to clarify and reinforce the disciplines of GATT 1994 especially those of its Article XIX, to re-establish multilateral control over safeguards and to eliminate measures that escape such control. Despite the controversies over the efficiency of the SGA, the consensus is that its primary objective lies in the prohibition and lifting of these grey-area measures.<sup>527</sup> It is thus argued that the centrepiece of the SGA is a flat prohibition of new grey-area measures, coupled with a mandatory phasing out of existing measures by the end of 1999.<sup>528</sup> Since then, the prohibition of trade restrictions of this type constitutes not only a major achievement of the Uruguay Round but also one of the fundamental principles of the GATT system.<sup>529</sup>

However, a discernible deviation from the above achievements emerged during China's accession negotiation and the use of VERs was revived under Section 16 of the Accession Protocol. According to Section 16.2, if, in the course of these bilateral consultations, it is agreed that imports of Chinese origin are such a cause and that action is necessary, China shall take such action as to prevent or remedy the market disruption. Under this provision, considerable flexibility has been granted to the negotiating parties as to which types of measure should be the

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<sup>525</sup> Ibid, p. 24.

<sup>526</sup> Yong-Shik Lee, n.79, p.126.

<sup>527</sup> Kent Jones, 'The safeguard mess revisited: the fundamental problem', *World Trade Review*, (2004) 3, 83-91; Alan O. Sykes, n. 97.

<sup>528</sup> Alan O. Sykes, n.59, p. 26.

<sup>529</sup> Article XI GATT.

appropriate choice and to what extent they should be applied in the circumstances concerned. Among others, the use of VERs is not excluded, or to a certain extent, implicitly indicated. It becomes even more questionable when such a reversal of the policy was adopted to single out one Member for an easier import restraint while policy against VERs is still prevailing with respect to products from other Members. It has already been argued that this selective revival of grey-area measures presents a serious challenge to the integrity of the WTO rules and policies.<sup>530</sup>

In contrast, more policy similarities could be found in the contemplated safeguard actions, which refer to the unilateral measures enforced by the importing Member where no mutually acceptable resolution has been achieved during the consultations. According to Section 16, if consultations do not lead to an agreement between China and the WTO Member concerned within 60 days of the receipt of a request for consultations, the WTO Member affected shall be free, in respect of such products, to withdraw concessions or otherwise to limit imports only to the extent necessary to prevent or remedy such market disruption.<sup>531</sup> Subsequent to the imposition of unilateral safeguard measures, Section 16.6 envisages the retaliation on the part of China, depending on the cause and duration of the measure. In particular, China has the right to suspend the application of concession or other GATT obligations if the safeguard measure resulting from a relative increase of import remains in effect more than two years, or, when caused by an absolute import increase, if it remains in effect for more than three years. In contrast, under the SGA, only one time limit of three years is established against the absolute import increase and the exporting countries are entitled to immediate suspensions of equivalent concessions or other GATT obligations in the case of relative import increase.<sup>532</sup>

In sum, there are two possible outcomes in the application of Section 16: either China enforces the VER agreed on during the consultations, which would be free from any compensation afforded by the importing Member; or, in the case where no agreement could be reached, the importing Member is entitled to impose unilateral restriction after the consultation period, which is nevertheless subject

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<sup>530</sup> Yong-Shik Lee, n.79, p.126.

<sup>531</sup> Section 16.3 Accession Protocol.

<sup>532</sup> Article 8 SGA.

to the possible retaliatory action from China.

In the latter case, a WTO Member shall apply a measure pursuant to this Section only for such period of time as may be necessary to prevent or remedy the market disruption.<sup>533</sup> Indeed, the sufficiency of prevention or remedy is assessed during the preliminary investigation, which is thus exclusively subject to the decision of the investigating authorities. In other words, transitional safeguard measures could be maintained in force until the importing Member is convinced by the non-existence and the non-recurrence of market disruption. Otherwise, Section 16 also envisages extension of the measure in force, subject to the condition that the competent national authorities had determined upon the necessity of the continuation.<sup>534</sup>

Hence, on the one hand, Section 16.6 suggests that the measure shall be temporary in nature in that it has to be terminated once the market disruption or the threat of it no longer exists. On the other hand, however, no maximum duration for the application period is established and the possibility of extension is permitted on a unilateral basis. In contrast, the SGA introduces a fixed maximum ceiling of eight years regardless of the possible action renewal.<sup>535</sup> Consequently, it has been argued that safeguard actions under Section 16 can be maintained in force as long as the duration of that Section itself.<sup>536</sup> This observation, however, does not exclude the implied time restrictions upon such measures, beyond which China might initiate retaliatory actions.

## **2.2 Trade diversion safeguards**

Besides the original and direct export destination, Section 16 also provides extra protection for the so-called third-country importing Members. This refers to the trade diversion safeguards under Section 16.8 allowing the third-country Members to apply a safeguard action where there are actual or threatened significant trade diversions of a particular Chinese product from the market of the Member applying the market disruption safeguards. Actions of this type will

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<sup>533</sup> Section 16.6 Accession Protocol.

<sup>534</sup> Para 246(f) Working Party Report.

<sup>535</sup> Article 7.3 SGA.

<sup>536</sup> Yong-Shik Lee, n.79, p.126.

start with bilateral consultations between China and the third-importing Member concerned. When the time period of 60 days elapses, the importing Member would be entitled to impose import restriction or withdraw concessions in the case of the failure of consultations. Thus, it is very likely that safeguard actions against China start in one country due to market disruption and quickly cascade to all other significant markets on the basis of trade diversion.<sup>537</sup>

### **2.2.1 Substantive thresholds of trade diversion**

Trade diversion is defined in Para 247 of the Working Party Report as an increase of imports from China of a product into a WTO Member as the result of an action by China or other WTO Members. Para 248 further enumerates the objective criteria that have to be considered in determining the existence of trade diversion. In particular, the factors to be examined include: the actual or imminent increase in market share of imports from China in the importing WTO Member; the nature or extent of the action taken or proposed by China or other WTO Members; the actual or imminent increase in the volume of imports from China due to the action taken or proposed; conditions of demand and supply in the importing WTO Member's market for the products at issue; and the extent of exports from China to the WTO Member(s) applying a market disruption measure and to the importing WTO Member.

In contrast to the market disruption safeguards discussed earlier, a set of less onerous conditions apply in the trade diversion context. From a substantive perspective, it is remarkable, or even surprising, that no requirement regarding the injury test is mentioned in the text and the only triggering condition turns out to be the increase in imports, or the threat thereof, from China following the imposition of a market disruption safeguard in another WTO Member.

### **2.2.2 Application of the trade diversion safeguards**

From a procedural perspective, no obligation regarding the preliminary

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<sup>537</sup> Huan Liu and Laixiang Sun, 'Beyond the phase-out of quotas in the textiles and clothing trade: WTO-plus rules and the case of US safeguards against Chinese exports in 2003', *Asia-Pacific Development Journal*, (2005) 11, 49-71.

investigation is mentioned under Section 16.8; rather, the starting sentence uses the fairly subjective word “consider”.<sup>538</sup> It is thus indicated that, as soon as there is one WTO member implementing a Section 16 measure against Chinese exports, all other members can enforce a similar measure at almost no procedural cost.<sup>539</sup> However, this textual shortcoming does not raise many problems in practice, since the most influential importing Members, such as the US, Canada and the EU, chose to follow the same procedures as those against market disruption.<sup>540</sup> This practice is plausible in that it not only guarantees, to a certain extent, the procedural justice for the Chinese exporters and producers but it also prevents the abusive use of this mechanism by the investigating authorities.

### 2.2.3 Textual ambiguities

In terms of the implementation in practice, the trade diversion safeguard mechanism under Section 16 is considerably vitiated by the textual ambiguities of relevant provisions. For example, it is required in both Section 16.8 of the Accession Protocol and Para 247 of the Working Party Report that any trade diversion has to be significant. The question first arises as to whether the word “significant” means that only an absolute increase in imports could be taken into account or whether a relative increase also qualifies. In spite of the objective criteria required in Para 248 of the Working Party Report, the meaning of this term is still far from clear. Moreover, with regard to the causal link between the market disruption safeguards in force and the subsequent trade diversion, Para 247 simply stipulates that “the action taken to address market disruption has caused or threatened to cause the diversion”.<sup>541</sup> It is thus questionable whether the existing safeguard action has to be the single reason for the trade diversion or just one factor among other causes.

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<sup>538</sup> Section 16.8 provides that “if a WTO Member considers that an action taken under paragraphs 2, 3 or 7 causes or threatens to cause significant diversions of trade into its market, it may request consultations with China and/or the WTO Member concerned”.

<sup>539</sup> Messerlin Patrick A., ‘China in the WTO: anti-dumping and safeguards’, *World Bank Economic Review*, (2004) 18, 105-130, p. 127.

<sup>540</sup> Marco Bronckers and Martin Goyette, ‘The special safeguard clause in WTO trade relations with China: (How) Will it work?’, Marco C.E.J. Bronckers and Gary N. Horlick (eds), *WTO Jurisprudence and Policy: Practitioners' Perspectives*, London: Cameron May, 2004, 427-438.

<sup>541</sup> Para 247 Working Party Report.

### **2.3 Summary remarks**

Following on from the preceding discussion on the safeguard instruments under Section 16, it is not difficult to conclude that the transitional mechanism is characterised by released constraints upon the restriction-imposing country. Compared with the SGA, such release under Section 16 in substantive threshold and other issues in the course of application, i.e. unlimited action duration and additional protection for trade diversion, indeed provides the importing Member for a more forcible instrument to cope with the import surge from China.

In the meanwhile, the transitional safeguards suffer to a considerably extent from the difficulties of textual brevity in that many terms under Section 16 are not clearly defined and thus require further elaboration. For possible resolutions, Section 16 should be first read against the general background of Article XIX GATT and the SGA. Wherever possible, the provisions thereunder should be considered as the best source of reference for implementation difficulties. For the purpose of interpretation, recourse shall also be made to the same term that is used under other WTO agreements, as well as the explanation provided in existing WTO jurisprudence. Even if the above approaches cannot solve all the problems that have emerged, they nevertheless provide a good departure point towards disciplined use of the transitional safeguard instruments, especially when they are entrusted with much released requirements for action.

### ***Section III. Para 242 of the Working Party Report: the textile-specific safeguard mechanism***

During the period 1995 – 2005, international trade in T&C went through fundamental reform under the ATC. As mentioned earlier, this sector reform did not apply to imports from China until the completion of its WTO accession; thus the first commitment thereafter was to catch up with the progress which had been achieved during the first six-year of ATC liberalisation. Relevant provisions in this regard are established in Para 241 of the Working Party Report. In the meanwhile, considerable concern arose among WTO Members with regard to the potent production and exporting potential of China T&C industries. It was

particularly worried that in this specific sector, Section 16 safeguards could not provide sufficient leeway for the industries in most WTO Members to tackle the import surge from China. As a result, alongside the transitional safeguards under Section 16, a textile-specific mechanism of a transitional nature was negotiated during the accession and was eventually established under Para 242 of the Working Party Report.

With regard to the relationship between Section 16 and Para 242, Para 242 (g) stipulates as follows: measures could not be applied to the same product at the same time under this provision and the provisions of Section 16. While prohibiting simultaneous application of the two mechanisms, this provision entrusts the importing Member to invoke either of them to shield its domestic industries from the T&C surges from China. Insofar as safeguard actions are not doubly imposed on the same product at the same time, the choice between Section 16 and Para 242 is solely subject to national decisions on a case-by-case basis.

According to Para 242, where the importing WTO Member believes that the textile products from China are, owing to market disruption, threatening to impede the orderly development of trade, such Member could request consultations with China. Upon the receipt of the request for consultations, China should then agree to hold its shipments of the categories in question to the specified levels.<sup>542</sup> If no solution is reached during the 90-day consultation period, the importing Member could continue the limits mentioned above while consultations would continue. No action could remain in effect beyond one year without reapplication, unless otherwise mutually agreed between the Member concerned and China.

In general, Para 242 is characterised by the immediate enforcement of action upon the consultation request. On this point, Para 242 (c) imposes an obligation on China to carry out restrictions on the contested exports as soon as the request for consultation is received. In contrast to other safeguard mechanisms under the

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<sup>542</sup> Para 242 (c) provides “upon receipt of the request for consultations, China agreed to hold its shipments to the requesting Member of textile or textile products in the category or categories subject to these consultations to a level no greater than 7.5 per cent (6 per cent for wool product categories) above the amount entered during the first 12 months of the most recent 14 months preceding the month in which the request for consultations was made”.

WTO, first of all, such grey-area measures in the form of VER have been explicitly prohibited under the SGA;<sup>543</sup> second, unilateral action is usually not allowed or required prior to the completion of the consultations. According to Article XIX:2 GATT, before the enforcement of any action, it shall give the WTO Members having a substantial interest as exporters of the product concerned an opportunity to consult with it in respect of the proposed action;<sup>544</sup> also, under Section 16, China is obliged to take self-restrictive actions only after an agreement is reached between the parties.

### **3.1 Substantive thresholds under Para 242**

The substantive thresholds to invoke an action under Para 242 are summarised as follows: in the event that a WTO Member believed that imports of Chinese origin of textiles and apparel products covered by the ATC as of the date the WTO Agreement entered into force, *were, due to market disruption, threatening to impede the orderly development of trade in these products*, such Member could request consultations with China with a view to easing or avoiding such market disruption” (emphasis added).<sup>545</sup> According to this Article, Para 242 actions share the same threshold of “market disruption” with safeguards under Section 16; and understanding of this term has been analysed in detail in the preceding discussion.<sup>546</sup>

However, no provision under Para 242 shed light on the investigating rules that should be followed by the competent authorities before determining the existence of market disruption and initiating the request for consultations.<sup>547</sup> Thus, one might argue that Para 242 is established with the aim of providing better, or more comprehensive, protection for the domestic industries of WTO Members; as a result, Para 242 is intentionally designed to place China in a comparatively unfavourable position in the T&C trade. That is why the much lower thresholds and more relaxed conditions have been introduced. For the same reason, the

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<sup>543</sup> Article 11 SGA.

<sup>544</sup> Article XIX (2) GATT.

<sup>545</sup> Para 242 (a) Working Party Report.

<sup>546</sup> For detailed discussion, see Section 2.1.1.

<sup>547</sup> Dongli Huang, ‘Legal interpretation of Paragraph 242 of the Report of the Working Party on the accession of China under the World Trade Organization legal framework’, *Global Trade and Customs Journal*, (2006) 40, 137-152, p.141-143.

omission of provisions regarding investigation procedures signified that greater discretion should be granted to the investigating authorities in comparison with the SGA.

Indeed, this argument is rather misleading and its adverse influence cannot be overestimated. When compared with imports from other WTO Members, Chinese products might be discriminated against in accordance with the multilaterally agreed provisions; but such discriminatory treatment further highlights the significance of essential procedural obligations in order to prevent abusive use of the unfavourable rules thereunder. That is to say, the discriminatory arrangement against China can be realised only through lowering the substantive requirements and conditions, rather than decreasing the standard protection for procedural fairness. Lack of specification in this regard does not mean that the Para 242 mechanism is born without procedural constraints. It has already been argued that provisions under Article 3 SGA on the preliminary investigation shall equally apply to Para 242 although yet not articulated in the text.<sup>548</sup>

At this juncture, more straightforward reference than the SGA rules mentioned above could be found in Section 16.5 of the Accession Protocol and Para 246 of the Working Party Report, which are drafted to implement and interpret the term “market disruption”. As mentioned earlier, “market disruption” is the major determinant under Para 242, which should be understood in the same way as the same term under Section 16. Therefore, required procedures associated to this term shall also be followed accordingly. In fact, few discrepancies, if any, could be identified between Para 246 and Article 3 SGA, except those concerning the protection of confidential information in the latter.<sup>549</sup>

### **3.2 Application of the Para 242 measures**

The application issues under Para 242 will be analysed through a comparison with the WTO safeguards under Article XIX GATT and the SGA. The following discussion will attempt to answer the questions as to what types of actions are contemplated under Para 242 and how these measures can be enforced in practice. As a preliminary observation, the disadvantageous position of China is discernible under Para 242, which is notably characterised by the lack of trade compensation and the markedly lowered thresholds for action. However, as will

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<sup>548</sup> Ibid.

<sup>549</sup> Article 3.2 SGA.

be mentioned later, these unfavourable elements are to a certain extent compensated by the shorter action duration envisaged therein.

### **3.2.1 Contemplated measures under Para 242**

According to Para 242 (b), (c) and (d), the duty of immediate VER is imposed on the part of China. In particular, China has to control the textile consignments to a level no greater than 7.5 per cent (6 per cent for wool product categories) above the amount entered during the first 12 months of the most recent 14 months preceding the request for consultations.<sup>550</sup> In the case of failure to reach any agreed resolution in the consultations, the same action will be continued but enforced by the importing Member instead. Thus, the above restriction with fixed quantitative ceiling is the only action contemplated under Para 242, the form and level of which are rigid and unchangeable.

In contrast, the WTO safeguards do not strictly mandate actions in particular forms. According to Article 6 SGA, a provisional safeguard measure pursuant to a preliminary determination should take the form of tariff increases. With regard to the definitive measures, Article XIX GATT provides, under certain circumstances, the importing Member shall be free to suspend the obligation in whole or in part or to withdraw or modify the concession. Furthermore, Article 5 SGA sets forth several application requirements for quantitative restrictions and other types of quotas.<sup>551</sup> Alongside the foregoing reference to tariff increases and import quotas, importing Members are in the meanwhile not prevented from adopting actions in other forms. Based on the notification submitted to the WTO safeguard committee, the most widely used safeguards are ranked as follows: the *ad valorem* tariff increases, tariff rate quotas, specific tariff increases and quantitative restrictions.<sup>552</sup>

In sum, when no mutually satisfactory solution is reached during the consultations, on the one hand, the SGA entrusts the importing Members with considerable discretion in deciding the form and level of the measure to be adopted. On the other hand, under Para 242, the measures envisaged could

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<sup>550</sup> Para 242 (a) - (d) Working Party Report.

<sup>551</sup> Article 5 SGA,

<sup>552</sup> Petros C. Mavroidis, Patrick A. Messerlin, Jasper M. Wauters, n. 65, p. 481.

merely take the form of quantitative restrictions subject to specified ceilings.

### **3.2.2 Duration of Para 242 measures**

Under both Para 242 and the SGA, duration of safeguard measures is an issue to be determined during either the consultation or the investigation process. There are nonetheless two limits in this regard, which refer to the earliest time point to initiate the action and the maximum period of the application duration.

As Para 242 (c) provides, China is under the obligation of immediate action upon the receipt of the consultation request. Thus, the point of action under Para 242 should be a short period after the request is made. By contrast, according to Article XIX:2 GATT, no action can start until the completion of consultations.<sup>553</sup>

With regard to the maximum application duration, Para 242(f) stipulates that “no action taken under this provision would remain in effect beyond one year, without reapplication, unless otherwise agreed between the Member concerned and China”. Conversely, under the SGA, the total period of applying a safeguard measure including the period of any provisional measure, the period of initial application and any extension thereof, shall not exceed eight years.<sup>554</sup> Therefore, Para 242 follows a more restrictive approach since all its measures have to be removed within a one-year time without the possibility of extension.

### **3.2.3 Other application issues under Para 242**

There have been some debates concerning the issue of which party should be responsible for the measure enforcement where no mutually satisfactory solution is reached during the consultation period. According to Para 242, it is China that is obliged, or entitled, to hold the shipment upon the consultation request; however, it is questionable whether this situation should be changed as the consultation period of 90 days elapses.

When no agreement can be achieved, Para 242(d) requires “consultations would

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<sup>553</sup> Article XIX GATT.

<sup>554</sup> Article 7 SGA.

continue and the Member requesting consultations could continue the limits". It is thus argued that the action executor should shift from China to the importing Member. Meanwhile, the opposite position argues that Para 242 is intended to allow, or require, China to maintain the existing measure in force rather than entitle the requesting WTO Member to do so.<sup>555</sup> This argument is mainly based on the presumption that if unilateral action is allowed to the importing Member through authorising its own customs to impose quantitative restrictions, China will be deprived of the opportunity to conduct meaningful consultations with the importing Member concerned. In particular, China, which has already been facing trade restrictions, will be located in a disadvantageous bargaining position during the continued consultations; and the importing Member, with the quantitative restrictions in force, will also lose the motivation to conduct constructive consultations with China, since the aim of restricting imports has already been achieved and the effect could nevertheless be maintained whether the mutually satisfactory solution is achieved or not.

These two arguments should be viewed in the light of the interpretation approaches established under the VCLT. Indeed, in accordance with Article 31 VCLT, interpretation of the WTO agreements has followed a general text-based approach, which means interpreters shall mainly focus on the literal meaning of the treaty text and the guidance in the context of the treaty language.<sup>556</sup> Thus, the latter argument in support of enforcement on the part of China, although proved with certain practical rationale, constitutes only a second guess in detecting the real intention of the contracting parties. It can by no means override the dictionary meaning of the text, according to which the action executor should be switched onto the Member requesting the consultations.

Implementation in practice also provides answers to this debate. Take the EU as an example. Article 10(a) of Regulation 3030/93, which is adopted for the implementation of Para 242, provides that "the Commission may, if no mutually satisfactory solution is reached during the 90-day consultation period, establish a quantitative limit for the category or categories subject to the consultations; the

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<sup>555</sup> Dongli Huang, n.135, p.141-143.

<sup>556</sup> Federico Ortino, 'Treaty interpretation and the WTO Appellate Body Report in *US-Gambling: A critique*', *Journal of International Economic Law*, (2006) 9, 117-148; Isabelle Van Damme, 'The interpretation of schedules of commitments', *Journal of World Trade*, (2007) 41, 1-52.

quantitative limit shall be set up on the basis of the level at which China held its shipments upon receipt of the Community's request for consultation".<sup>557</sup> It thus becomes clear that the Para 242 action enforced by China shall last for no more than 90 days and the EU will take over the enforcement thereafter.

### **3.3 Summary remarks**

#### **3.3.1 System features of the transitional safeguards in T&C**

Similarly to Section 16, actions under Para 242 apply on a selective basis and depart from the MFN principle. In particular, Para 242 allows WTO Members to place restrictions on specific Chinese products while simultaneously imports of the same product from other WTO Members are unrestricted. Furthermore, Para 242 also shares another significant characteristic with the previous T&C safeguard mechanisms, i.e. Article 3 of the MFA and Article 6 of the ATC, in that it does not grant China the right for compensation and retaliatory actions.

Revival of the so-called grey-area measures represents yet another deviation from the SGA. In fact, safeguards under both Section 16 and Para 242 have restored the use of VERs but to a different extent: the former merely provides the possibility of revival through mutually agreed action enforced by China; while the latter, apart from offering the same option during the negotiation process, further mandates China to control its exports upon a request for consultations. In particular, there is a great chance under Section 16.2 that the mutually satisfactory solution reached in the consultations will take the form of VERs. Meanwhile, reliance on such restrictions turns out to be more straightforward under Para 242, where China is under the automatic obligation to hold its shipment of textile products below the specified ceilings.

Last but not least, it has to be pointed out that, compared with other T&C safeguards, Para 242 further relaxes the substantive conditions triggering restrictions. In particular, it brings down the threshold in the injury test from "serious" to "material".

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<sup>557</sup> Council Regulation 138/2003 amending Regulation 3030/93 on common rules for imports of certain textile products from third countries, OJ, L 23, 28/01/2003, p. 1 – 3.

In sum, due to the deviations from traditional safeguard mechanisms mentioned above, Para 242 can no longer be considered as an economic safety valve in the conventional sense. Rather, apart from the assigned title as a safeguard instrument, this mechanism resembles, to a large extent, an anti-dumping device. First of all, they are both founded on discriminatory, or selective, application in contrast to the *erga omnes* nature of safeguard actions irrespective of the sources of imports. Second, actions under Para 242 are subject to the same injury test as Article VI GATT and the ADA. Instead of the threshold of “serious injury” required under the SGA, actions under Para 242 and the ADA are triggered upon the “material injury” caused to the domestic industries. Third, neither the compensation for trade losses nor the retaliatory action is provided for the Member suffering restrictions, but self-restrictive actions are nevertheless available under both mechanisms. Parallel to the availability of VERs under Para 242, Article 8 ADA establishes a similar device of voluntary price undertakings. In the case of a preliminary affirmative determination of dumping and injury, anti-dumping proceedings may be suspended or terminated without the imposition of provisional measures or anti-dumping duties upon the receipt of satisfactory voluntary price undertakings from the exporters to revise and increase their prices so that the authorities are satisfied that the injurious effect of the dumping is eliminated. It has already been argued that the voluntary price undertakings lead to an outcome quite similar to that generated by VERs: in economic models, a comparison of price undertakings and VER regimes yield outcomes that are similar in terms of the impact on welfare and the inefficiencies generated.<sup>558</sup>

### **3.3.2 Effectiveness analysis of the T&C instrument under Para 242**

The question also arises as to whether, under the current practice in international trade, Para 242 can be recognised as an effective instrument for trade frictions in the T&C sector. The answer would probably be negative owing to the bilateral nature of the resolution envisaged thereunder. As the previous experience disclosed, the US and the EU respectively invoked Para 242 in 2005 and the subsequent consultations eventually led to the mutually satisfactory solutions in

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<sup>558</sup> Chad P. Bown, n.56, p.53.

the form of bilateral agreements.<sup>559</sup> Furthermore, Para 242 actions were generally exempted from the obligation of notification to the WTO, which is explicitly mandated under Section 16 and the SGA. Thus, such bilateral T&C restrictions were mainly falling outside the multilateral surveillance from the WTO and remarkable flexibility was left in the hands of the Members involved.

On this point, it has been argued that the value chain of international trade has now evolved to a stage where distortions and shocks can no longer be solved by bilateral agreements alone but instead should be considered under multilateral regimes such as the WTO.<sup>560</sup> The value chains starting from China, which is the largest supplier in T&C trade, could spread across the globe. For example, the supply chain from a Chinese clothing factory to a supermarket in New York is fraught with participants all over the world.<sup>561</sup> Apart from the direct consequence of Para 242 actions in volume decrease from China and price increase in New York, the side effects on many other participants in the same value chain cannot be overestimated. However, they were not involved, or excluded from, the consultation process and as a result, their interests were generally neglected, or even jeopardised under the bilateral resolutions finally reached. Therefore, all governments should make efforts to avoid playing the WTO rules for the advantage of particular domestic interest groups and to prevent the recurrence of the classical tragedy that short-term or opportunistic politics lead to disappointing economics and reduced welfare.<sup>562</sup>

### **3.3.3 Comparative study between Section 16 and Para 242**

The comparison between Section 16 and Para 242 not only demonstrates the specific protection provided in the T&C sector; more importantly, due to the termination of the latter at the end of 2008, it also indicates the changes of safeguard policy towards T&C products from China afterwards. First and foremost, Section 16 no longer provides the option of mutually satisfactory solutions in the form of bilateral agreements, such as the EU-China textile MOU

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<sup>559</sup> In particular, the US and China concluded a memorandum of agreement on import-level restraints on 21 categories of textiles and clothing products from China in November 2007; and the EU and China signed a similar pact in June 2005.

<sup>560</sup> Huan Liu and Laixiang Sun, n.125.

<sup>561</sup> *Ibid*, p.66.

<sup>562</sup> *Ibid*, p.69.

concluded under Para 242.<sup>563</sup> According to Section 16, in the case of common recognition of the necessity of action during the consultations, the only option is the grey-area measure on the part of China.<sup>564</sup>

Moreover, compared with the quantitative restrictions imposed under Section 16, the advantages of Para 242 agreements, in the light of the importing Member, are manifest. First of all, while Section 16 usually targets one single product, Para 242 could impose restrictions on a group of products. Second, according to Section 16.2, grey-area measures enacted by China shall be notified immediately to the Committee on Safeguards, which are thus subject to the multilateral surveillance at the WTO. Third, for the quantitative restrictions under Section 16, China is entrusted with retaliatory action if the quotas, as a safeguard action, are maintained in force beyond a certain period of time.<sup>565</sup> This constitutes a substantial switch in safeguard policy. As mentioned earlier, the unavailability of compensation and retaliation action was one of the common features among T&C safeguard mechanisms, namely, Article 3 MFA, Article 6 ATC and Para 242 of the Working Party Report.

However, in one circumstance, Section 16 offers additional protection for the importing Member. This refers to the trade divergent safeguard under Section 16.8 defending the interest of the third-country Members as indirect export destinations. As discussed earlier, safeguard measures of this type are not imposed as a result of the domestic injury; rather, it is the surge in import volume caused by restrictions taken by another importing Member that actually triggers the restriction.

#### ***Section IV. Evaluation of the China-specific contingency trade instruments***

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<sup>563</sup> For detailed discussion, see Chapter IV Section 2.2.2.

<sup>564</sup> Section 16.2 Accession Protocol.

<sup>565</sup> According to Section 16.6 of the Accession Protocol, China is entitled to suspend the application of substantially equivalent concessions or obligations under GATT 1994 to the trade of the WTO Member applying the measure, if such measure remains in effect more than two years as a result of a relative increase in the level of imports and three years in the case of an absolute increase.

#### **4.1 The revival of bilateralism**

Preference for the bilateralism approach among the China-specific contingency trade instruments is evident. Under Section 15 of the Accession Protocol, negotiation with the WTO Member concerned is the only way for China to obtain market economy status prior to the deadline envisaged, since the relevant standards are entirely subject to the national decision. Moreover, as the practice illustrates, the most common outcome in the safeguard application under Para 242 is the conclusion of a bilateral agreement setting out the mutually satisfactory solution reached in the consultations.

However, such a bilateral approach should be applied under the multilateral WTO system with sufficient caution. As mentioned earlier, most international transactions nowadays are based on widespread value chains rather than the point-to-point trade relations between just two countries. The bilaterally agreed solution, in most cases, fails to take into account the benefits and losses of other participants involved and thus cannot be considered as an adequate resolution in terms of the influence the pending friction might result globally.

Furthermore, this approach also leads to the marked erosion of WTO integrity. For example, as indicated in Section 15 of the Accession Protocol, various standards and definitions of the same concept “market economy” exist among the WTO Members. Therefore, the same country, which qualifies as a market economy in most Members, might nevertheless be treated as a NME in a few others. This is exactly the situation China is facing at the current stage.

Alongside the potential unfairness for the third-country Members and the adverse effect on WTO integrity, it is also submitted that bilateral dialogues usually involve intense governmental bargaining covering a wide range of issues of political sensitivity, the consideration of which goes far beyond an objective economic assessment. In the context of the market economy status, as mentioned earlier, political motivation played an important role in bilateral negotiations on this issue before the relevant decision was taken, especially following pressure from the affected domestic industries.

#### **4.2 Para 242 safeguards: the voluntary undertaking of China**

Para 242 remarkably intensifies and prolongs the sectoral protection in T&C in that, with the designated duration of seven years, it came into effect when two thirds of the ATC reform had been completed and the entire sector was about to integrate into the GATT in three years' time. The most noteworthy point is that all these efforts dedicated under this Paragraph are wholly due to the potential of import surge from one single source, rather than the overall trends of the world T&C trade.

Upon the expiry of the ATC, the T&C sector, after the ten-year structural reform, is eventually integrated into the WTO system and exclusively governed by the GATT rules. Since then, specific trading regime in this sector no longer exists and Para 242 becomes the only T&C special instrument maintained in force applied exclusively towards products of Chinese origin. If the parallel safeguard device under Section 16 is founded upon the NME nature of China's economy, Para 242 can only be considered as a response to the general weak competitiveness of the domestic industries in most WTO Members. Against the general liberalised market in T&C, the introduction of Para 242 is indeed a stark policy fallback.

It might be argued that other developing countries that are also exporters of T&C had to wait for ten years until full market access was allowed; thus, why it is unfair for China to have the same sector access in three-year time while allowing for the possibility for certain additional safeguards. At this juncture, however, the justice or unfairness of a trade regime cannot be simply connected to the length of the so-called "tolerance period", which should be instead assessed in the light of the economic and legal rationale underlying such regime. The fact that it took ten years to finally open the T&C market to most developing exporters does not necessarily mean that the same length of time or the same reform process should be repeated all over again for the market-opening to China.

Indeed, this question should be viewed in terms of the domestic development,

especially the readiness of the market and industries in the importing Members, rather than being based on the origin of the imports. Since 1995, WTO Members were well aware of their pressing and compulsory commitments of T&C market opening in ten-year time but not sufficiently substantial and effective measures were domestically enforced for self-improvement. Therefore, in spite of the deficient sectoral competence in their T&C industries to compete directly with the imported products, WTO Members should no longer be allowed to invoke sectoral restrictions seeking for further breathing space after 2005. All the restrictions thereafter should be imposed in accordance with the WTO disciplines on contingent trade protection.

Nevertheless, it is exactly the lack of competitiveness, which China should not be held responsible for, that led to the negotiation and conclusion of Para 242. If the establishment of the buffering mechanisms under Sections 15 and 16 can be explained by the systemic defects in China's economy, under Para 242, the only possible accusation attributable to China is its dynamic and potent production and export potential in T&C. As the previous Para 242 actions showed, China, through imposing VERs on its own exports, is helping to redress and restore the sectoral weakness caused by the WTO Members themselves. Therefore, the only plausible explanation seems to be that China is voluntarily offering, or is forced to offer, extended protection for the T&C industries in other Members, namely another four-year time for sectoral adjustment after the expiry of the ATC.

### ***Chapter conclusion***

This chapter has examined two contingency instruments established in China's WTO accession documents, namely the transitional anti-dumping and safeguard mechanisms.

The special anti-dumping regime derives from the controversial issue of NME. It is originally inspired by Ad Article VI GATT and further elaborated in Section 15 of the Accession Protocol. During the GATT era, the application of NME regime in anti-dumping was not uncommon but becomes a rare practice under the WTO system. The WTO rules in this regard are couched in a rather generic and brief

manner, which leaves the Members considerable manoeuvrability in developing their own NME policies. The most widely used methodology is the combined approach of the analogue country approach in the normal value calculation and the one country-one duty principle in the duty imposition. The EU anti-dumping legislation in this area constitutes a typical example, which is of great significance and will be discussed in the next chapter.

In the field of safeguards, two distinct devices, owing to different policy considerations, are specified in the accession documents, namely the Section 16 product-specific safeguards and the Para 242 textile-specific safeguards. In particular, the former is negotiated and agreed on as part of the buffering mechanism with the aim of interfacing the NME into the WTO system. In contrast, Para 242 is simply based on the domestic incompetence in WTO Members to cope with the impact of the T&C imports from China.

In general, these two safeguard devices share the same substantive threshold of market disruption and are subject to the identical procedural requirements under Para 246. Discrepancies nonetheless exist in other issues. From the perspective of importing Members, Section 16 gains advantages in the longer duration of application and the possibility of measure extension. However, due to the lack of immediate action and the chance of retaliatory actions from China, Para 242 might be preferred.

So far, experience in practice indicates a clear policy preference among the China-specific instruments above, which is generally in accordance with the overall dominance of anti-dumping in contingent trade protection. Detailed examination in this regard will be provided in the coming chapter. Here, suffice it to say, when discussing the choice of trade instruments restricting products from China, factors, like the NME treatment and the availability of quotas, should also be taken into account.

Furthermore, the foregoing instruments are strongly characterised by the reliance on bilateral approaches. On the one hand, it might be true that, in most cases, a mutually acceptable solution between certain trading partners is more efficient and accelerated than the across-the-board agreement. On the other hand, over-

dependence on bilateralism may nonetheless render the integrity of the WTO at stake, or even lead to a policy regression within a small group of the Members.

This chapter will be concluded by the following discussion envisaging the future developments of WTO contingency policy towards China. To begin with, given the termination of Para 242 safeguards at the end of 2008, the current China-specific instruments consisted of only those under Sections 15 and 16 of the Accession Protocol. In the field of anti-dumping, there is still the chance that the NME status of China expires earlier than the stipulated 15 years.<sup>566</sup> It is because, first of all, more and more WTO Members have granted the market economy treatment to imports of Chinese origin, including several major trading entities such as the Association of Southeast Asian Nations (ASEAN), Brazil, Argentina, South Africa, Russia, New Zealand and Australia. Second, as the domestic reform in economy structure further develops in China, the remaining Members refusing to do so would face considerable pressure, not only from China and other trading partners, but also from their own industries and enterprises.

In the field of safeguards, the co-application of Section 16 and the SGA might be maintained until the end of the transitional period of 12 years.<sup>567</sup> So far, a definitive conclusion with regard to the popularity between these two mechanisms has not emerged yet. Despite Section 16 reducing the substantive threshold down to “material injury”, the situation in practice has not revealed obvious preference towards it. It is partially due to the scarce cases where the importing Member decided to invoke safeguard measures, instead of contingency instruments in other forms, to achieve the aim of import control. At the current stage, there are nevertheless two observations regarding the future use of safeguards towards China. First, the choice between the SGA and Section 16 is solely under the discretion of the importing Member. Second, Section 16 appears to be only option if the affected WTO Member is suffering from market impact arising from trade diversion rather than direct imports from China.

In the sector of T&C, insofar as imports from China are concerned, the trend of sectoral protection can be summarised as follows: quantitative restrictions in the

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<sup>566</sup> Section 15(d) Accession Protocol.

<sup>567</sup> Section 16.9 Accession Protocol.

form of import quotas used to be the principal instrument during the MFA and the ATC era; as the ATC came to an end, 2005 saw frequent use of the Para 242 safeguards, which led to a revival of quotas upon certain textile categories imported into the US and the EU.<sup>568</sup> With regard to the subsequent trade instrument that prevails in this sector, it is submitted that, after the flat prohibition of import quotas, there is a great chance for the incremental use of contingency measures; and thus the policy choice in T&C, which in the past showed obvious preference for quotas and Para 242 safeguards, will probably switch to the anti-dumping action under Section 15. In contrast, Section 16 might be much less frequently invoked owing to the reduced protection for domestic interests and other application inconvenience from the perspective of the importing Member.<sup>569</sup> This observation has already been proven in practice thus far and the next chapter will provide a detailed comparative study between these two instruments in the EU context.

In particular, based on the preceding discussion that explores the transitional contingency instruments affiliated to China's WTO membership, the ensuing chapter will examine their implementation under the EU import regime. First of all, it will look into how the EU manipulates the national discretion permitted at the WTO and establishes its China-specific contingency regime in accordance with the accession documents. Furthermore, it also attempts to investigate whether and how the released thresholds under the transitional mechanisms have influenced the application, as well as the popularity, of different contingency instruments in practice.

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<sup>568</sup> For example, the EC issued Guidelines for the use of the Textile Specific Safeguard Clause (TSSC) on 6 April 2005, and launched investigations on nine categories of China's textiles exports on 24 April 2005. The US imposed safeguard restrictions on three categories of China's textiles exports on 13 May 2005, and on four categories on 18 May 2005.

<sup>569</sup> For detailed discussions on policy preference, see Chapter IV Section 3.1.

## CHAPTER IV. THE EU CONTINGENT TRADE PROTECTION TOWARDS CHINA

It is a conventional practice of the EU to separate imports from China from those of other exporting countries and to grant differential treatment. This separation is mainly due to the previously central-planned economy of China, which is now defined as “transitional” according to the EU criteria.

Against this background, this chapter will examine the contingency instruments under EU’s China-specific import regime. The subsequent discussion will focus on the EU trade defence instruments (TDIs) in the form of anti-dumping and safeguards that apply exclusively to China. Indeed, their application represents the EU implementation process of the transitional mechanisms under China’s WTO membership, which have been analysed in the last chapter.

### ***Section I. The EU anti-dumping rules against China: the dilemma between market economy and NME***

The EU import regime draws a fundamental distinction between the NMEs and those where market economy prevails.<sup>570</sup> This is particularly prevalent under the so-called Basic Anti-dumping Regulation, namely, Regulation 1225/2009 on protection against dumped imports from countries not members of the EU.<sup>571</sup> Until 1998, China had been treated as a NME regarding all anti-dumping proceedings initiated by the EU, from dumping investigation to duty imposition. This practice was changed by Regulation 905/98, which brought several significant amendments to the status of China.<sup>572</sup> In particular, it not only removed China from the list of NME countries, it further set up a new anti-dumping regime applicable to it. These amendments of the legislation were intended, at least in part, to extend the possibility to Chinese producers and exporters of benefiting from a fairer approach

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<sup>570</sup> Anne MacGregor, ‘The special market economy regime in EC anti-dumping law: an assessment of the Commission’s practice to date and a case study’, *International Trade Law and Regulation*, (2001) 7, 26-38.

<sup>571</sup> Council Regulation 1225/2009 on protection against dumped imports from countries not members of the European Community, OJ, L 343, 22/12/2009, p. 51-73.

<sup>572</sup> Council Regulation 905/98 amending Regulation 384/96 on protection against dumped imports from countries not members of the European Community, OJ, L 128, 30/4/1998, p. 18–19.

to the determination of individual dumping margins.<sup>573</sup> Since then, China has been defined as an economy in transition under the EU import regime; and the applicable anti-dumping rules are different from those for either non-market or market economies.

This legal differentiation indeed envelops China between these two distinct treatments. On the one hand, the removal of China from the NME list was not equal to the recognition of market economy status and did not result in market economy treatment. In this regard, China made its first request for country-wide market economy status in September 2003. A preliminary assessment was carried out by the Commission in June 2004, which came to the conclusion that China did not fulfil all the criteria required.<sup>574</sup> The high-level working group, established after the EU-China summit in 2005, met twice during 2006 with particular focus upon the reform efforts made by China in the field of the accounting and financial sectors. Both sides expressed their satisfaction over the progress of the market economy status dialogue; however, it was also highlighted that further progress was still needed.<sup>575</sup> In June 2007, the Commission issued another assessment. Although it reflected the significant and welcome steps of China towards a market economy, especially with regard to the adoption of a number of important laws, the Commission considered that none of the four outstanding criteria has been met in full. Further progress, especially the proper implementation of the new pieces of legislation, became the essential steps towards improvement.<sup>576</sup> The detailed criteria mentioned above will be investigated later. Here, it is nonetheless important to recall that the assessment, according to the EU, is merely a technical exercise for the sole purpose of trade defence investigation and thus the conclusion should not be viewed as a judgment of the general functioning of the Chinese economy or a political judgement on whether a market economy *per se* exists in China.<sup>577</sup>

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<sup>573</sup> Robert M. MacLean, 'Evaluating the impact of the EC's conditional market economy principle in Chinese and Russian anti-dumping cases', *International Trade Law and Regulation*, (2001) 7, 65-75.

<sup>574</sup> 'China – market economy status in trade defence investigations', Brussels, 28 June 2004, available at [http://trade.ec.europa.eu/doclib/docs/2004/june/tradoc\\_117795.pdf](http://trade.ec.europa.eu/doclib/docs/2004/june/tradoc_117795.pdf).

<sup>575</sup> 25th Annual Report from the Commission to the European Parliament on the Community's anti-dumping, anti-subsidy and safeguard activities, SEC (2007) 1076, COM 479, section 5.

<sup>576</sup> 'EU-China trade relationship at a crossroads', Peter Mandelson, available at [http://ec.europa.eu/commission\\_barroso/mandelson/speeches\\_articles/sppm162\\_en.htm](http://ec.europa.eu/commission_barroso/mandelson/speeches_articles/sppm162_en.htm).

<sup>577</sup> Commission Staff Working Document on Progress by China towards Graduation to Market Economy Status in Trade Defence Investigations, p.5, available at [http://www.antidumpingpublishing.com/uploaded/documents/Other/Miscpercent20ADpercent20Decisions/EUpercent20-percent20Chinapercent20MESpercent20Reportpercent20\(Septpercent202008\).pdf](http://www.antidumpingpublishing.com/uploaded/documents/Other/Miscpercent20ADpercent20Decisions/EUpercent20-percent20Chinapercent20MESpercent20Reportpercent20(Septpercent202008).pdf)

On the other hand, the market economy treatment is no longer a mission completely impossible for individual Chinese exporters and producers. In fact, there is now the possibility for them to be treated in the same way as their counterparts from countries of market economies, provided that they can prove the cumulative satisfaction of the conditions under Article 2.7(c) of the Basic Anti-dumping Regulation. In particular, it is provided that if it is shown that market economy conditions prevail for the producer or producers in respect of the manufacture and sale of the like product concerned, normal value will be determined in much the same way as any other products from a market economy country. Otherwise, the anti-dumping policies for the NME shall apply.<sup>578</sup>

Therefore, at the current stage, there are three methodologies available under the EU anti-dumping regime towards imports from China, namely, the NME treatment, the market economy treatment and the individual treatment. Indeed, the individual treatment, to a certain extent, splits the difference and is thus considered as a moderate approach between the other two options.

### **1.1 NME treatment under the EU anti-dumping law: the analogue country approach and one country-one duty principle**

As discussed in Chapter III, in the implementation of the NME treatment under Article VI GATT and Section 15 of the Working Party Report, it is a widespread practice that WTO Members follow the combined methodologies of the analogue country approach and the one country-one duty principle.<sup>579</sup> In most cases, anti-dumping proceedings under the NME treatment result in a single anti-dumping duty charge imposed upon all the exporters, irrespective of the producer-specific circumstances. As one of most frequent users of anti-dumping, the EU has incorporated such practice into the Basic Anti-dumping Regulation.<sup>580</sup>

Moreover, the EU NME treatment is also characterised by the unknown NME standards and the discretionary selection of the analogue country. Under the EU import regime, no detailed standards or definition for NME has ever been

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<sup>578</sup> Regulation 1225/2009, n.2.

<sup>579</sup> For detailed discussion on this issue, see Chapter III Section 1.3.

<sup>580</sup> Article 2.7 Regulation 1225/2009, n.2.

announced or published. Rather, the conventional approach in this regard is to enumerate a list of countries which, according to the Commission, should be categorised as NMEs in anti-dumping operations. This list is stipulated in a footnote under Article 2.7 of the Basic Anti-dumping Regulation but the selection criteria are not disclosed.<sup>581</sup> As mentioned earlier, China has been removed from that list since 1988. For the selection of the analogue country, which appears to be another critical but controversial step under the NME regime, Article 2.7(a) of the Basic Anti-dumping Regulation stipulates the general tenet as follows: an appropriate market economy third country, not excluding the Community itself, shall be determined on the reasonable basis in a not unreasonable manner, due account being taken of any reliable information available at the time of selection.<sup>582</sup>

Further elaboration on this issue is provided in the *Nölle* case. According to the Court, even if the choice of the reference country is a matter falling within the discretion enjoyed by the institutions in analysing complex economic situations, the exercise of that discretion is not excluded from, but merely subject to, review by the Court in limited circumstances. In particular, the Court will verify whether the relevant procedural rules have been complied with, whether the facts on which the choice is based have been accurately stated and whether there has been a manifest error of appraisal or a misuse of powers. Furthermore, it is particularly desirable to verify the following two issues: first, whether the institutions neglected to take account of essential factors for the purpose of establishing the appropriate nature of the country chosen; and second, whether the information contained in the documents was considered with all the care required for the view to be taken that the normal value was determined in an appropriate and not unreasonable manner.<sup>583</sup> Therefore, this judgement not only provides specified elaboration on the selection criteria; more importantly, it also confirms the admissibility of judicial review on the appropriateness of the analogue country selected.<sup>584</sup> The success of the complainant in that case indeed indicates that the Commission's choice of the analogue country, although as an administrative decision under its discretion, remains subject to the legality review of the European Court.

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<sup>581</sup> Regulation 1225/2009, n.2. The recent codification in the Basic Anti-dumping Regulation reduces the NMEs to the following six countries: Azerbaijan, Belarus, North Korea, Tajikistan, Turkmenistan and Uzbekistan. Albania, Armenia, Georgia, Kyrgyzstan, Moldova and Mongolia were thus removed.

<sup>582</sup> Article 2.7(a) Regulation 1225/2009, n.2.

<sup>583</sup> Case C-16/90, *Eugen Nölle v Hauptzollamt Bremen-Freihafen* [1991] ECR I-5163, paras 11-13.

<sup>584</sup> *Ibid.*

### 1.1.1 The selection criteria of the analogue country

With regard to the selection criteria, the Basic Anti-dumping Regulation merely sets forth the general requirement of “reasonable consideration”. In practice, the investigating authorities conventionally take into account the following elements as the major selecting criteria: market competition in the analogue country, similarity of the production process, different quality levels of the products, and access to raw material. Any doubt with regard to the comparability in the foregoing elements will lead to either the disqualification of the analogue country or a proportionate allowance or adjustment to the data collected from that country.

Indeed, the allowance and adjustment constitute an essential step during the NME investigation. If fundamental disparity in economic systems could be identified between the analogue country selected and the NME under investigation, further divergence in specific economic varieties is doubtlessly unavoidable, especially those influencing export activities and domestic sales. However, the Basic Anti-dumping Regulation, which mandates compulsory allowance in the case of market economy, does not shed light on the same issue between the analogue country and the NME.<sup>585</sup>

Under the current EU practice, adjustment under the NME treatment would not be made for all types of cost difference. According to the Commission, unnecessary adjustment of the costs would render the investigation in the analogue country meaningless and it would lead to adjust the normal value to NME levels.<sup>586</sup> Instead, the investigation will mainly focus on the natural competitive advantages of the NME that do not occur in the analogue country, i.e. access to raw materials; and the cost comparative advantages on account of the NME, such as low-cost labour force, are generally excluded. This practice indeed results in a rather unfavourable position of the NME since the most valuable advantages enjoyed by the producers and the exporters are simply ignored during the preliminary investigation. In

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<sup>585</sup> For the market economy investigation, Article 2.10(K) provides “any adjustment may also be made for differences in other factors not provided for under subparagraph (a) to (j) if it is demonstrated that they affect price comparability as required under this paragraph”.

<sup>586</sup> Council Regulation 1659/2005 imposing a definitive anti-dumping duty and collecting definitively the provisional duty imposed on imports of certain magnesia bricks originating in the People’s Republic of China, OJ, L 267, 12/10/2005, p. 1, Recital 22.

particular, the following elements are generally excluded from the selection process: the different stages of economic development, the comparison between the labour costs and the comparability of the size of the domestic markets. The EU provides two reasons for such exclusion: first, due to the nature of the economic system in the NME or the economy in transition, information from these countries is not the result of the play of market forces and thus cannot be relied on.<sup>587</sup> Second, in specific cases, especially where the industry under investigation is not labour-intensive, labour costs merely account for a small amount in terms of the total production costs, which is thus considered irrelevant, or of little significance.<sup>588</sup> As a result, a series of complaints have been brought to the Court regarding the biased assessment of the comparability, as well as the disregard of certain elements mentioned above. On several occasions, the Court verified the choice made by the Commission and the following issues have been, to a certain extent, clarified.

First of all, the Court agreed with the Commission that the size of the domestic market is not in principle a factor capable of being taken into consideration in the choice of a reference country, insofar as during the period of the investigation there is a sufficient number of transactions to ensure the representative nature of the market in relation to the exports in question.<sup>589</sup> The question then arises as to what is the threshold for “a sufficient number of transactions” that can ensure the representativity of the analogue market. However, the Court did not provide a clearly quantified picture in this regard. In *Brother Industries*, the Court rejected a challenge to the institutions' practice of fixing the minimum level of representativity of the domestic market at 5% of the exports in question.<sup>590</sup>

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<sup>587</sup> Council Regulation 1095/2005 imposing a definitive anti-dumping duty on imports of bicycles originating in Vietnam, and amending Regulation 1524/2000 imposing a definitive anti-dumping duty on imports of bicycles originating in the People's Republic of China, OJ, L 183, 14/7/2005, p. 1–36; Council Regulation 1659/2005, n.17; Council Regulation 1987/2005 imposing a definitive anti-dumping duty and collecting definitively the provisional duty imposed on imports of granular polytetrafluoroethylene (PTFE) originating in Russia and the People's Republic of China, OJ, L 320, 8/12/2005, p. 1–19.

<sup>588</sup> Council Regulation 1467/2004 imposing a definitive anti-dumping duty and collecting definitively the provisional duty imposed on imports of polyethylene terephthalate originating in Australia, the People's Republic of China and terminating the anti-dumping proceeding concerning imports of polyethylene terephthalate originating in Pakistan and releasing the amounts secured by way of the provisional duties imposed, OJ, L 271, 19/8/2004, p. 1-17; Council Regulation 1174/2005 imposing a definitive anti-dumping duty and collecting definitively the provisional duty imposed on imports of hand pallet trucks and their essential parts originating in the People's Republic of China, OJ, L 189, 21/7/2005, p. 1-14.

<sup>589</sup> Joined cases C- 305/86 and C-160/87, *Neotype Techmashexport GmbH v Commission and Council*, [1990] ECR I-2945, para 31.

<sup>590</sup> Case [250/85](#), *Brother Industries v Council*, [1988] ECR 5683, paras 12-13.

However, in the *Nölle* case, the total production of Sri Lanka, which was chosen as the analogue country, represented only 1.25% of the volume of the Chinese exports in question. The Court thus opined that this figure amounted to an indication that the market considered was not very representative.<sup>591</sup>

Second, it is also settled case law that neglect of access to raw materials is not admissible. In *Nölle*, the Commission contended that the alleged advantage resulting from access to raw materials cannot be satisfactorily quantified in a NME country and that in any event such an advantage may be offset by other competitive advantages existing in a market economy country. This argument was refused by the Court, which confirmed “it follows from the Community institutions' established practice that the comparability of access to raw materials must be taken into consideration for the choice of reference country”.<sup>592</sup>

Third, jurisprudence also shed light on the approach that the investigating authorities should take towards the analogue country suggested by the NME exporters. In general, institutions are not required to consider every reference country suggested during an anti-dumping proceeding. Only in the case where serious doubts arise, the Commission ought to examine the proposal made by the exporter in greater depth.<sup>593</sup> In *Nölle*, in spite of the fact that various factors known to the institutions were such as to raise doubts as to the appropriateness of Sri Lanka as a reference country, the institutions nevertheless failed to make a serious or sufficient attempt to determine whether Taiwan, as suggested by the applicant, could be considered as an appropriate candidate. Therefore, the Court considered that the normal value was not determined “in an appropriate and not unreasonable manner” within the meaning of Article 2(5)(a) of the basic regulation.<sup>594</sup>

The above practice and legal principles under the EU regime nevertheless bring about certain deviation from the provisions multilaterally agreed in Para 151 of the Working Party Report. Insofar as the issue of comparability is concerned, Para 151 specifies the selection criteria of analogue country as “one or more market economy countries that were significant producers of comparable merchandise and that either

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<sup>591</sup> Case C-16/90, *Eugen Nölle v Hauptzollamt Bremen-Freihafen*, n.14, paras 20-22.

<sup>592</sup> *Ibid*, paras 25-26.

<sup>593</sup> *Ibid*, paras 30-32.

<sup>594</sup> *Ibid*, paras 35-36.

were at a level of economic development comparable to that of China or were otherwise an appropriate source for the prices or costs to be utilized in light of the nature of the industry under investigation”.<sup>595</sup> Among others, the consideration regarding economic development is clearly excluded from the current decision-making process of the EU.

### **1.1.2 Potential WTO violation of the EU NME policy**

Despite the fact that the WTO agreements grant considerable discretion for the Members to establish their own NME regime,<sup>596</sup> EU’s current practice can nevertheless be challenged in the light of the provisions under China’s accession documents.

According to Section 15 of the Accession Protocol, “if the producers under investigation can clearly show that market economy conditions prevail in the industry producing the like product with regard to the manufacture, production and sale of that product, the importing WTO Member shall use Chinese prices or costs for the industry under investigation in determining price comparability”.<sup>597</sup> Thus, the assumption, as well as the textual interpretation, seems to be that the grant of market economy treatment stands for the prevalence of market force in the entirety of a particular industry, which consists of all the enterprises producing the similar products. Following this assessing approach at the “industry” level, market economy treatment, if established, should be granted to the group of enterprises engaged in that specific sector. In contrast, the EU has adopted an “enterprise” approach in the sense that, during the market economy test, the Commission will look into the Chinese producers on an individual basis. It is thus a common practice that, in a single anti-dumping proceeding, certain producers are granted market economy treatment while others in the same industry are classified into the NME regime.

In the investigation against integrated electronic compact fluorescent lamps from China, two producers were granted market economy treatment in the provisional

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<sup>595</sup> Para 151(a) Working Party Report.

<sup>596</sup> For detailed discussion, see Chapter III Section I.

<sup>597</sup> Section 15 (a)(i) Accession Protocol.

decisions.<sup>598</sup> During the subsequent investigation, some interested parties proposed that normal values be determined on the prices of these two Chinese producers granted market economy treatment, instead of the producers from the analogue country. However, this request was refused in the regulation imposing the definitive duties.<sup>599</sup> Thereafter, two Chinese companies subject to the NME treatment lodged a case in the Court. One of the claims was that the fact that they were not operated fully in accordance with market economy conditions could not prevent their normal value from being determined differently. Insofar as there were Chinese producers which qualified in the market economy test, normal value for all the producers in that industry must be determined in the same way.<sup>600</sup> In other words, the central question lay in whether the normal value for producers denied market economy treatment should be determined on the prices from the Chinese producers entitled to this treatment, or from those in an analogue country. In that case, the applicants did not raise the issue of WTO-compatibility of the Regulation concerned; instead, they argued that the use of data from the analogue company was clearly inappropriate and unreasonable.<sup>601</sup>

However, this claim was refused by the Court. In particular, it was ruled that, according to Article 2.7 of the Basic Anti-dumping Regulation, the investigating institutions may choose to apply another calculation method rather than the analogue country approach only where the latter turns out to be impossible; and such impossibility arises only where the data required in order to determine normal value are not available or are not reliable.<sup>602</sup> However, in that case, the fact that it is necessary to adjust the data from the analogue country does not demonstrate either the impossibility or the inappropriateness.<sup>603</sup>

The Court's interpretation of the Basic Anti-dumping Regulation was fair and accurate. However, the compliance of the Regulation with the WTO rules,

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<sup>598</sup> Commission Regulation 255/2001 imposing a provisional anti-dumping duty on imports of integrated electronic compact fluorescent lamps (CFL-i) originating in the People's Republic of China, OJ, L 38, 08/02/2001, p. 8-21.

<sup>599</sup> Council Regulation 1470/2001 imposing a definitive anti-dumping duty and collecting definitively the provisional duty imposed on imports of integrated electronic compact fluorescent lamps (CFL-i) originating in the People's Republic of China, OJ, L 195, 19/07/2001, p. 8-14.

<sup>600</sup> Case T-255/01, *Changzhou Hailong Electronics & Light Fixtures Co. Ltd and Zhejiang Yankon Group Co. Ltd v Council*, [2003] ECR II-4741, para. 30.

<sup>601</sup> *Ibid.*, para 57.

<sup>602</sup> *Ibid.*, para 59.

<sup>603</sup> *Ibid.*

particularly those under Section 15 of the Accession Protocol, is another issue. Indeed, it is highly questionable whether the enterprise-based NME approach under Article 2.7 is compatible with the “industry” assessment explicated in Section 15. It is particularly the case where market economy treatment is granted to certain companies while others in the same industry are decided to be not qualified. The major issue refers to whether the grant of such treatment could indicate the prevalence of market conditions industrial-wide; if so, the investigating authorities would have to explain the reasons why other participants in the same industry are deprived of this treatment.

Furthermore, under this circumstance, the applicability, as well as the appropriateness, of the analogue country approach also becomes contestable. It is argued that the best reflection of the normal value for the NME enterprises should be the prices of those Chinese producers, which are entitled to market economy treatment.<sup>604</sup> Therefore, it might go against the fundamental fairness, as required under the WTO anti-dumping regime, to use the data from the analogue country, the appropriateness of which can by no means compare with the home market in China.

In sum, under the current EU regime, the Chinese exporters cannot avoid the unfavourable decision of dumping by simply ensuring that their export prices are equal or superior to their domestic prices. If they want to avoid anti-dumping action they need access to supernatural resources. In particular, they have to know at the time of exporting which analogue country the Commission will select in a future investigation, not knowing when such an investigation will take place, if ever.<sup>605</sup> For its unpredictability, the method of using a reference country has been described as the trade policy equivalent of charging a driver with speeding on a road with no posted limits, based upon the limits posted on some other road – a road that will be chosen after the driver has been stopped.<sup>606</sup>

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<sup>604</sup> Henrik Andersen, *EU Dumping Determinations and WTO law*, Kluwer Law International, Wolter Kluwer, 2009, p.342.

<sup>605</sup> Piet Eeckhout, ‘European anti-dumping law and China’, available at <http://eiop.or.at/eiop/texte/1997-007a.htm>, p.2.

<sup>606</sup> David Palmetier, *The WTO as a Legal System: Essays on International Trade Law and Policy*, London: Cameron May, 2003, p.19-20.

## **1.2 Market economy treatment**

To recall the earlier observation that as an economy in transition, there is the possibility for Chinese exporters to benefit from the market economy treatment during the investigation. According to Article 2.7(b) of the Basic Anti-dumping Regulation, if the criteria and procedures set out are met, the producers and exporters under investigation should be treated in the same way as any other producers from a market economy country. The conditions required are explained as follows.

“A claim under subparagraph (b) must be made in writing and contain sufficient evidence that the producer operates under market economy conditions, that is if:

— decisions of firms regarding prices, costs and inputs, including for instance raw materials, cost of technology and labour, output, sales and investment, are made in response to market signals reflecting supply and demand, and without significant State interference in this regard, and costs of major inputs substantially reflect market values,

— firms have one clear set of basic accounting records which are independently audited in line with international accounting standards and are applied for all purposes,

— the production costs and financial situation of firms are not subject to significant distortions carried over from the former non-market economy system, in particular in relation to depreciation of assets, other write-offs, barter trade and payment via compensation of debts,

— the firms concerned are subject to bankruptcy and property laws which guarantee legal certainty and stability for the operation of firms, and

— exchange rate conversions are carried out at the market rate.

A determination whether the producer meets the abovementioned criteria shall be made within three months of the initiation of the investigation, after specific consultation of the Advisory Committee and after the Community

industry has been given an opportunity to comment. This determination shall remain in force throughout the investigation.”

During the early years’ practice, the EU seemed to have followed a more liberal approach in the market economy assessment. This was witnessed in cases such as *Pocket Lighters* and *Zinc Oxides* where, respectively, six out of eight and three out of five Chinese companies qualified.<sup>607</sup> However, a recent study revealed that, for the period of 2000-2005, the success rate of Chinese applications was only 36 per cent.<sup>608</sup> The policy switch towards cautiousness is thus manifest. Before analysing the specific criteria mentioned above, the ensuing part will first discuss the general principles established in case law under this test.

### 1.2.1 General principles established in case law

First of all, in order to be recognised as an enterprise being operated under market economy conditions, the exporter under investigation has to prove that it meets all the criteria under the Basic Anti-dumping Regulation. According to the Court, it follows both from the use of the word ‘and’ between the fourth and fifth indents of Article 2.7(c) and from the very nature of the criteria set out there that the criteria are cumulative in nature. Consequently, should a producer claiming this treatment fail to fulfil one of them, its claim must be rejected.<sup>609</sup>

Second, it is also observed that, in the sphere of measures to protect trade, the Community institutions enjoy a wide discretion by reason of the complexity of the economic, political and legal situations which they have to examine.<sup>610</sup> A review by the Community judicature of assessments made by the institutions must be limited

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<sup>607</sup> 2003/645/EC: Commission Decision terminating the anti-dumping proceedings concerning imports of disposable gas-fuelled pocket lighters originating in the People's Republic of China, Indonesia, Malaysia and Vietnam and terminating the interim review of the anti-dumping duty on imports of gas-fuelled, non-refillable pocket flint lighters originating in the People's Republic of China or consigned from or originating in Taiwan and on imports of certain refillable pocket flint lighters originating in the People's Republic of China or consigned from or originating in Taiwan, OJ, L 228, 12/9/2003, p. 35–37; Council Regulation 408/2002 imposing a definitive anti-dumping duty and collecting definitively the provisional duty imposed on imports of certain zinc oxides originating in the People's Republic of China, OJ, L 62, 5/3/2002, p. 7–14. Edwin Vermulst and Folkert Graafsma, ‘Recent EC anti-dumping practice towards China and Vietnam: the great gap backward?’, *International Trade and Regulation*, (2006) 12, 124-129.

<sup>608</sup> Helena Detlof and Hilda Fridh, ‘The EU treatment of non-market economy countries in anti-dumping proceedings’, *Global Trade and Customs Journal*, (2007) 2, 265-281, p. 276-277.

<sup>609</sup> Case T-35/01, *Shanghai Teraoka Electronic v Council*, [2004] ECR II-3663, para. 54.

<sup>610</sup> *Ibid*, para. 48

to establishing whether the relevant procedural rules have been complied with, whether the facts on which the contested choice is based have been accurately stated and whether there has been a manifest error of assessment of those facts or a misuse of power.<sup>611</sup> Moreover, the same applies to factual situations of a legal and political nature in the NME concerned.<sup>612</sup>

Thus, the Court, on the one hand, recognised that the liberal discretion of the Community institutions in TDIs applied equally to the market economy test. On the other hand, it nevertheless pointed out that, by laying down precise criteria for the grant of market economy treatment, the Council limited its own discretion, with the intention of taking into account the “changed economic conditions” in China.<sup>613</sup> In other words, the exercise of wide discretion cannot go beyond the limits set out in Article 2.7(c). According to the Court, although it cannot intervene in the assessment reserved for the Community authorities, it is still under the responsibility to make sure that, as part of the investigation which the institutions are obliged to carry out for the purposes of Article 2.7(b) and (c), they took account of all the relevant circumstances put forward by the exporting producer and that they appraised them with all due care.<sup>614</sup>

Third, the grant of market economy treatment, in particular, the method of determining the normal value of a product set out in Article 2.7(b), is an exception to the specific rules applicable to imports from NME countries. It is thus settled case law that any derogation from or exception to a general rule must be interpreted strictly.<sup>615</sup>

Lastly, case law has also shed light on the issue of burden of proof, which, according to the Court, lies upon the exporting producer in the NME. As Article 2.7(c) provides, the claim for market economy status must contain “sufficient evidence”. Accordingly, there is no obligation on the Community institutions to prove that the exporting producer does not satisfy the criteria laid down for the recognition of such status. On the contrary, it is for the Community institutions to

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<sup>611</sup> Ibid, para. 49.

<sup>612</sup> Ibid.

<sup>613</sup> Case T-498/04, *Zhejiang Xinan Chemical Industrial Group v Council*, delivered on 17 June 2009, para.105.

<sup>614</sup> Ibid, para.106.

<sup>615</sup> Case T-35/01 *Shanghai Teraoka Electronics v Council*, n.40, para 50.

assess whether the evidence supplied by the exporting producer is sufficient to show that the criteria laid down in Article 2.7(c) are fulfilled and for the Community judicature to examine whether the institutions' assessment is vitiated by a manifest error.<sup>616</sup> Therefore, the underlying rationale behind this allocation of proof seems to be that the Community would automatically take China as a NME unless it is otherwise proved. Based upon the foregoing judicial principles, the next section will proceed to analyse the specific criteria under the test.

### **1.2.2 The first criterion under the test**

For the first criterion regarding commercial independence, the Community legislature specifically requires that the decision-making process of the concerned exporting undertaking be autonomous from any significant State interference. It is thus for the company to show, first, that its decisions on prices, costs and inputs are made independently, based on considerations typical of a market economy, namely, the maximising of profit. Second, it also has to prove that they are not influenced by considerations peculiar to the State. The applicant thus must demonstrate that the State does not exercise excessive influence over the allocation of economic resources in the decisions of companies. This influence might take the form of price fixing, obligations to produce for export, restrictions imposed on exports of raw materials or subsidies for individual inputs.<sup>617</sup>

It is argued that this criterion has, to a certain extent, been quantified in practice, which is often interpreted as whether there is partial state ownership. If this ownership exceeds 50%, then state interference is assumed and MET will be automatically rejected. However, in situations where the state owns less than 50% but more than 10%, the tendency has been to assume state interference.<sup>618</sup> According to the latest Commission assessment upon the overall market economy status, this criterion has not been fulfilled in the economy system of China, which is vitiated by the continued practice of discretionary price setting, the fixing of utility rates, restrictions on exports and imports and the subsidisation of inputs.<sup>619</sup>

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<sup>616</sup> Ibid, para 53.

<sup>617</sup> Commission Staff Working Document, n.8, p. 7.

<sup>618</sup> Edwin Vermulst and Folkert Graafsma, n.38.

<sup>619</sup> Commission Staff Working Document n.8, p.12.

For the meaning of the term “significant State interference”, the Court seized the opportunity, in *Zhejiang Xinan*, to deliver further explanation.<sup>620</sup> First, this term must be assessed in the light of the way that “decisions of firms regarding prices, costs and inputs” are made.<sup>621</sup> Conduct by the State, which is not such as to influence those decisions cannot constitute “significant State interference” within the meaning of Article 2.7(c).<sup>622</sup> Second, in view of the wording, purpose and context of that provision, this concept cannot be assimilated to any given influence on the activities of an undertaking or to any involvement in its decision-making process, but must be understood as meaning action by the State which is such as to render the undertaking’s decisions incompatible with market economy conditions.<sup>623</sup> This conclusion in particular refers to a gravity test, which requires the influence from the state to be sufficiently serious, or significant, as provided. Furthermore, the very use of the expression “significant” is also evidence of the Community legislature’s intention to allow a certain degree of state influence over an undertaking’s activities or of state involvement in its decision-making process if it has no effect on the manner in which its decisions concerning prices, costs and inputs are made.<sup>624</sup>

In the *Zhejiang Xinan* case, one of the reasons that the Commission declined the market economy request of the applicant lay in its findings regarding state control over the applicant, as well as the appointment and composition of its board of directors. According to the Commission, although the majority of the shares were owned by private parties, the State is still by far the biggest share owner of the company. Moreover, the board of directors was in fact appointed by the State shareholders and the majority of the directors of the board were either State officials or officials of State-owned enterprises.<sup>625</sup> In its defence, the applicant nevertheless raised the doubt regarding whether such state control could be equal to “significant state interference” that would result in the refusal of market economy treatment.

In the judgement, the Court first made the distinction between the term “state

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<sup>620</sup> Case T- 498/04, *Zhejiang Xinan Chemical Industrial Group v Council*, n.44.

<sup>621</sup> *Ibid*, para. 84.

<sup>622</sup> *Ibid*, para. 84.

<sup>623</sup> *Ibid*, para. 85.

<sup>624</sup> *Ibid*, para. 86.

<sup>625</sup> Council Regulation 1683/2004 imposing a definitive anti-dumping duty on imports of glyphosate originating in the People’s Republic of China, OJ, L 303, 30/9/2004, p. 1–18, Recitals 13.

control” invoked by the Commission and the term “significant state interference” stipulated under Article 2.7(c). In fact, the Commission actually followed the approach assimilating these two terms in the course of investigation.<sup>626</sup> However, this approach would lead to the exclusion of all state-controlled companies from entitlement to market economy treatment, irrespective of the real factual, legal and economic context in which they operate, and, more pertinently, of the evidence supporting the claim that the decision-making process is indeed independent from state interference. On this point, the Court believed that there are still cases where the state does not go beyond the role of a normal shareholder and the undertaking’s decisions are made freely and independently of considerations peculiar to the state; and therefore, those decisions are based exclusively on purely commercial considerations, appropriate to an undertaking operating under market economy conditions.<sup>627</sup> With regard to the composition of the applicant’s board of directors, the Court also opined that this issue cannot be put into doubt by the fact that the control which the State exercises over the company remains within the limits of the usual mechanisms of the market.<sup>628</sup>

As a result, the Court concluded that state control over an undertaking is a matter which may possibly be taken into account; however, it is not sufficient, by itself, to demonstrate the existence of “significant state interference” within the meaning of Article 2.7(c).<sup>629</sup> State control, as established in this case, is not, as such, incompatible with the taking of commercial decisions by the undertaking concerned in keeping with market economy conditions and, in particular, does not mean that its decisions on prices, costs and inputs are based on considerations unrelated to an undertaking operating under such conditions.<sup>630</sup>

### **1.2.3 The second criterion under the test**

Apart from freedom in the decision-making process and the absence of significant “state interference”, Article 2.7(c) further mandates, as the second criterion, the compliance of the applicant’s accounting records with certain international

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<sup>626</sup> Ibid.

<sup>627</sup> Case T- 498/04, *Zhejiang Xinan Chemical Industrial Group v Council*, n.44, para. 92.

<sup>628</sup> Ibid, para. 93.

<sup>629</sup> Ibid, para. 102.

<sup>630</sup> Ibid, para. 90.

standards. This condition is probably the most common reason for the rejection of the market economy request.<sup>631</sup> According to the Commission assessments, full compliance with the Chinese “Generally Accepted Accounting Principles” was not sufficient to meet the requirements arising from international accounting standards.<sup>632</sup> However, policy development took place at the beginning of 2007 when China enforced the new law on “Accounting Standards for Business Enterprises”, the compliance of which with international norms has already been approved by the Commission,<sup>633</sup> thus, the remaining problem lies in the lack of trained accountants and efficient enforcement mechanism at the central and local levels.<sup>634</sup>

The previous experience saw an unequivocal difficulty in proving the compliance with “international accounting standards”, the meaning of which turns out to be ambiguous and controversial. In the anti-dumping proceedings against imports of certain electronic weighing scales from China, the Commission relied on the International Accounting Standards (IAS) in the assessment under Article 2.7(c). At the end of the investigation, the Commission found breaches of the applicant in three fundamental accounting concepts, as well as other relevant provisions under the IAS. Consequently, it was concluded that the applicant failed to fulfil the second criterion and the request for market economy treatment was thus declined.<sup>635</sup>

In the subsequent complaint lodged by the applicant before the Court, one of the major arguments raised referred to the wrong choice of the “international accounting standards”. The applicant argued that the IAS adopted by the Commission was not the prevailing standards in either China or the EU. In particular, these standards are not mandatory in China and within the EU they are mandatory only for certain undertakings.<sup>636</sup> In response, the Court first confirmed the fact that Chinese undertakings were not subject to such standards under the domestic law was irrelevant to the issue whether their accounts may be assessed in

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<sup>631</sup> Robert M. MacLean, n.4.

<sup>632</sup> Edwin Vermulst and Folkert Graafsma, n.38.

<sup>633</sup> Commission Staff Working Document, n.8, p.14.

<sup>634</sup> Ibid.

<sup>635</sup> Council Regulation 692/2005 amending Regulation 2605/2000 imposing definitive anti-dumping duties on imports of certain electronic weighing scales (REWS) originating, *inter alia*, in the People’s Republic of China, OJ, L 112, 3/5/2005, p. 1–7, Recital 17.

<sup>636</sup> Case T-299/05, *Shanghai Excell M&E Enterprise and Shanghai Adepteck Precision v Council*, delivered on 18 March 2009, para. 85.

the light of those standards, neither was the non-prevalence of the same standards within the EU.<sup>637</sup> It was further ruled that in the case of disputes over the choice of the “international accounting standards”, it is for the undertaking in question to prove that the standards selected by the institutions are not internationally accepted or that any infringements of those standards by its accounts do not constitute such infringements in the light of other internationally accepted standards. However, the applicant has not proved that either is the case here.<sup>638</sup>

#### **1.2.4 The third criterion under the test**

In contrast, the third criterion requiring the absence of NME influence in production and sales has caused less problems for the applicants. It has been argued that first of all, in the NME, the State is the owner of all resources and property, which can thus determine their uses; and second, if the State then turns towards a more open economy and properties change hands from the State to private ownership, it is necessary to determine the value of properties and assets.<sup>639</sup> This criterion is thus focused on how the company was privatised and prohibits the government from granting a producer certain competitive advantages by selling the assets at too low a price.<sup>640</sup> The transition process could have included a one-off subsidy, which might affect the costs of production; also systems of barter trade and payment through debt compensation, though uncommon, cannot be seen as alien to a market economy.<sup>641</sup> Assessment in this regard would help to verify whether a price charged at the market is fixed by market force or comes as a result of the subsidies received during the transition.

The typical carry-over from NME is a distortion of the price paid for land. The problem with the price of land can be reflected as the fact that the price paid was not the market price, that late payment of rent was in practice accepted, that the land use right was not properly appreciated, and that provisions on land rent did not include a periodical review.<sup>642</sup>

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<sup>637</sup> Ibid, paras. 86-87.

<sup>638</sup> Ibid, para. 90.

<sup>639</sup> Henrik Andersen, n.35, p. 312.

<sup>640</sup> Ibid.

<sup>641</sup> Helena Detlof and Hilda Fridh, n.39, p.271.

<sup>642</sup> Ibid, p. 277-278.

In *Apache Footwear*,<sup>643</sup> the Commission considered that the stipulation of a significantly low land rental between Apache, the Chinese footwear manufacturer under investigation, and two landlord entities constituted a significant distortion whose origin lay in the former NME system.<sup>644</sup> In particular, the Commission pointed out that the landlord entities possessed close links with the State authorities and were indeed represented on Apache's Board of Directors by the local Communist Party Committee. In the judgement, the Court confirmed most arguments of the Commission. In particular, the Court agreed that land rental at prices lower than the market price improved the financial situation of the company concerned by reducing its production costs, a factor which is likely to affect the data relating to the calculation of normal value.<sup>645</sup> Consequently, having regard to the links between the landlord entities and the Chinese authorities, the Commission could reasonably conclude that the third criterion had not been satisfied.<sup>646</sup>

At this juncture, however, it has to be pointed out that, according to the market economy assessments regarding China, the Commission has already approved the fulfilment of this criterion and confirmed the general absence of NME distortion in the Chinese market.<sup>647</sup> Hence, the contrasting conclusion reached in *Apache Footwear* at least indicates that until graduation to the overall market economy status, anti-dumping proceedings against Chinese enterprises would continue to be investigated on a case-by-case basis and failure in any criterion would lead to the decline of the request for market economy treatment.

### **1.2.5 Other testing points under the market economy assessment**

The last criterion concerns effective legal regimes operating in the economy with respect to property rights and bankruptcy. In China, private property has been explicitly recognised in the 2004 Constitution amendment and the private ownership rights of domestic firms were given further support in the Property Law effective as of October 2007. These are fairly positive developments; however,

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<sup>643</sup> Case T-1/07, *Apache Footwear Ltd and Apache II Footwear Ltd (Qingxin) v Council*, delivered on 9 December 2009.

<sup>644</sup> *Ibid*, paras 21 and 41.

<sup>645</sup> *Ibid*, para. 94.

<sup>646</sup> *Ibid*.

<sup>647</sup> 'China – market economy status in trade defence investigations', n.5; Commission Staff Working Document, n.8.

concerns arise with regard to the land ownership due to the lack of a fully operational registration system and unavailability of transaction records.<sup>648</sup> The situation of the bankruptcy law appears similar to the accounting rules discussed earlier: a new Bankruptcy Law came into force in June 2007 and a complete analysis of the implementation remains pending.

Furthermore, attention should also be paid to the last paragraph of Article 2.7(c), according to which, determination of the test shall remain in force throughout the investigation. Disputes in this regard nevertheless emerged in *Nanjing Metalink*.<sup>649</sup> In that case, the Commission announced the initiation of investigation against ferro molybdenum (FeMo) from China and, at the provisional stage, the applicant was awarded market economy status.<sup>650</sup> As a result, the provisional duty for the applicant was fixed at 3.6 per cent, in contrast to the general 26.3 per cent for most Chinese producers. Shortly after, the China Chamber of Commerce of Minmetals and Chemicals hosted a meeting and set up a grouping of Chinese FeMo producers.<sup>651</sup> This group accounted for 70 per cent of China's FeMo output and agreed to apply price and quantitative restrictions on exports of FeMo to the EU. The producers concerned were granted specific export allocations, which appeared to have been determined by taking into account the level of their provisional anti-dumping duties mentioned above. In particular, the applicant, which had been granted market economy treatment and subject to the lowest duty level, was allocated an export quota in excess of its production capacity.

Subsequently, in the regulation imposing definitive anti-dumping duties, the Commission revoked the market economy treatment previously awarded and the applicant was thus subject to the countrywide duty as all other exporters in China.<sup>652</sup> The applicant then lodged a complaint in the Court and argued that by revoking, in the course of the investigation, the market economy treatment previously granted to it, the Commission infringed Article 2.7(c), since the last sentence of the provision provides, without exception, that the determination in relation to market economy

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<sup>648</sup> Commission Staff Working Document, n.8, p.15.

<sup>649</sup> Case T-138/02, *Nanjing Metalink v Council*, [2006] ECR II-4347.

<sup>650</sup> Commission Regulation 1612/2001 imposing a provisional anti-dumping duty on imports of ferro molybdenum originating in the People's Republic of China, OJ, L 214, 8/8/2001, p. 3–18.

<sup>651</sup> The so-called Molybdenum and Molybdenum Products Coordination Group of China Chamber of Commerce of Minmetals and Chemicals.

<sup>652</sup> Council Regulation 215/2002 imposing definitive anti-dumping duties on imports of ferro molybdenum originating in the People's Republic of China, OJ, L 35, 6/2/2002, p. 1–8.

treatment is to remain in force throughout the investigation.<sup>653</sup>

On the contrary, the Commission began its defence by criticising the nature of the grouping practice. An accusation was lodged against the applicant for violating the criteria under Article 2.7(c) after the grant of market economy treatment. According to the Commission, the arrangement in question was clearly incompatible with the criterion of free determination of export prices and quantities that needs to be satisfied if market economy treatment was to be awarded or maintained. Moreover, these export constraints adopted under the auspices of the Chamber of Commerce, in agreement with several state-owned companies, strongly suggested significant State influence, and a serious risk of circumvention of the duties. Furthermore, such a pact was a clear and deliberate attempt to channel exports of one company via another company with a lower anti-dumping duty for the purposes of avoiding such duties.<sup>654</sup> Therefore, the Commission considered that the applicant's practice of aligning its operations and business decisions with other exporting companies in China was contrary to its prior declarations for market economy treatment and incompatible with the first criteria under Article 2.7(c).<sup>655</sup>

The Commission finally summarised the change in its original decision as follows. If the criteria set out in Article 2.7(c) have been complied with during the investigation period, the Commission can reasonably assume that the company will operate in the future with a sufficient degree of independence from the state and in accordance with market economy standards. However, in the present case the applicant has modified its behaviour since receiving the individual dumping margin and, consequently, no longer operates in accordance with market economy principles under Article 2.7(c). Whilst information relating to a period subsequent to the investigation should not normally be taken into account, in these exceptional circumstances, it is appropriate to take into account the new developments, which have the effect of rendering the previous conclusions manifestly unsound.<sup>656</sup>

In the judgment delivered in November 2006, the argument of the Commission was fully supported by the Court. In particular, it was ruled, on the one hand, that the

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<sup>653</sup> Case T-138/02, *Nanjing Metalink v Council*, n.80, para 28.

<sup>654</sup> Recital 13 Regulation 215/2002, n.83.

<sup>655</sup> Ibid.

<sup>656</sup> Recital 16 Regulation 215/2002, n. 83.

last paragraph of Article 2.7(c) prohibits the institutions from re-evaluating, for the purposes of determining the existence of dumping, the information which was already available to them at the time of the initial determination as to market economy treatment. On the other hand, however, where the party concerned is revealed, in the course of the investigation and possibly after the imposition of provisional measures, as not to be operating under market economy conditions within the meaning of Article 2.7(c), the last paragraph cannot lead to the effect that normal value retain to be determined in accordance with the rules applicable to countries with a market economy.<sup>657</sup> In other words, following the strict interpreting approach established in case law, the last paragraph of Article 2.7(c) does not preclude the grant of market economy treatment from being discontinued if a change in the factual situation on the basis of which such treatment was conferred no longer permits the conclusion that the producer concerned operates under market economy conditions.<sup>658</sup>

#### **1.2.6 How far can this treatment go?**

The central question to be answered in this part concerns whether the grant of market economy treatment will indeed offer Chinese exporters a more favourable position in the anti-dumping proceedings. As a starting point, the use of domestic costs and prices from the Chinese market would probably lead to a dramatically deflated dumping margin; and consequently, anti-dumping duties imposed under the market economy treatment would, in most cases, be reduced to a large extent. However, exceptions do exist.

First, according to the Basic Anti-dumping Regulation, the use of domestic information is no longer entirely guaranteed even for the exporters from a market economy country. In certain circumstances, the EU is entitled to set aside the domestic data from the exporting country and resort to other substitute approaches to calculate normal value, such as the constructed price and the export price to another third country, which might result in an inflated dumping margin.<sup>659</sup> For

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<sup>657</sup> Case T-138/02, *Nanjing Metalink v Council*, n.80, para 44.

<sup>658</sup> *Ibid*, para 47.

<sup>659</sup> Anne MacGregor and Arnoud Willems, 'Russia recognized as a market economy country in EC anti-dumping legislation: an overview of the 2002 amendments to Regulation 384/96', *International Trade Law and Regulation*, (2003) 9, 26-30.

example, the approach of constructed normal values involves a variety of calculation and allocation choices; and the results would thus be unpredictable and arbitrary, compared to price-based normal values.<sup>660</sup>

The 2002 amendments to the Basic Anti-dumping Regulation further increase the chance of resorting to the substitute approaches mentioned above. In particular, Regulation 1972/2002 specifies the situations where, for a market economy exporter, the Commission could disregard the domestic data: when prices are artificially low, when there is significant barter trade, or when there are non-commercial processing arrangements.<sup>661</sup> Moreover, this Regulation also inserts the option of using the information from another representative market. It is provided that “if costs associated with the production and sale of the product under investigation are not reasonably reflected in the records of the party concerned, they shall be adjusted or established on the basis of the costs of other producers or exporters in the same country or, where such information is not available or cannot be used, on any other reasonable basis, including information from other representative markets”.<sup>662</sup> Indeed, this provision resembles the NME analogue country approach to a large extent and thus any advantage of market economy treatment can be negated because information from third countries can still be used for the normal value determination.<sup>663</sup> Even if as an option of last resort, one possible outcome would be the domestic costs and prices of the Chinese exporters that have been already accorded market economy treatment are eventually replaced by the data from another representative country. Indeed, recourse has been increasingly made to this provision over the past years in the cases where certain Chinese exporters fulfilled the criteria under Article 2.7.<sup>664</sup>

Furthermore, it has already emerged in practice that the Commission would nevertheless employ the NME approach subsequent to the accord of market economy treatment. In particular, in the case where the exporter that has passed the Article 2.7 test fails to provide sufficient information concerning domestic prices

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<sup>660</sup> Edwin Vermulst, ‘The 10 major problems with the anti-dumping instrument in the European Community’, *Journal of World Trade*, (2005) 39, 105-113, p. 108.

<sup>661</sup> Article 2.3 Regulation 1225/2009, n.2.

<sup>662</sup> Article 2.5 Regulation 1225/2009, n.2.

<sup>663</sup> Joris Cornelis, ‘China’s request for market economy status and its impact on the use of trade remedies by the European Communities and the United States’, *Global Trade and Customs Journal*, (2007) 2, 105-115, p.111.

<sup>664</sup> *Ibid.*

and costs for the Commission to make a reasonably accurate finding on the amount of the anti-dumping duty, the Commission will decide the normal value on the basis of prices from an analogue country instead.<sup>665</sup> The lawfulness of this practice is highly questionable. It is not only because nowhere in the Basic Anti-dumping Regulation has authorised the switch of the calculation approach in this manner; the legality could also be challenged in terms of the unfairness of treating a qualified market economy enterprise with an unfavourable NME approach.

Problems also arise from the textual brevity of the legislation concerned. The related provisions under the Basic Anti-dumping Regulation are couched in a rather brief and generic way without referring to any objective standards. For example, the Regulation does not define “artificially low prices”, “the significant barter trade” and “the non-commercial processing arrangements” in clear terms, while the selection criteria of “representative market” are also missing. Therefore, the result will largely depend on the interpretation of the factual situation by the case-handlers in charge.<sup>666</sup> It has already been argued that the use of substitute calculating approaches takes back with the left hand what was given with the right hand.<sup>667</sup>

Second, the difference between the market and the non-market approaches mainly focuses on the breadth of dumping margin, which, however, is not the only determinant of the duty amount to be imposed. Even if both the WTO ADA and the Basic Anti-dumping Regulation provide that the amount of the anti-dumping duty shall not exceed the dumping margin, they nevertheless require the duty amount to be less than the margin if such lesser duty would be adequate to remove the injury to the domestic industry.<sup>668</sup> This “lesser duty rule” makes the amount of duty also dependent on the outcome of the injury elimination test, the result of which is closely linked to the capacity and output of the affected Community industries, as well as the interpretation approach employed in particular cases. In fact, in about half of all cases during 2002-2005, the injury margin was lower than the dumping

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<sup>665</sup> Commission Regulation 1627/2003 imposing a provisional anti-dumping duty on imports of sodium cyclamate originating in the People's Republic of China and Indonesia, OJ, L 232, 9/18/2003, p. 12-28.

<sup>666</sup> Anne MacGregor and Arnoud Willems, n.91.

<sup>667</sup> Edwin Vermulst and Folkert Graafsma, n.38.

<sup>668</sup> Article 9.1 ADA and Article 9.4 Regulation 1225/2009, n.2.

margin for at least one company per case, in some cases even considerably lower.<sup>669</sup> Therefore, all controversy regarding the establishment of dumping margins might have only a limited effect in practice,<sup>670</sup> and it is indeed the injury levels, in the above cases, that determined the amount of duties.

Following the preceding analysis of the NME and the market economy treatment under the EU anti-dumping regime, the coming part will move on to another methodology that might be adopted in the anti-dumping proceeding against products from China, namely, individual treatment.

### **1.3 Individual treatment**

Article 9.5 of the Basic Anti-dumping Regulation establishes individual treatment as an exception to the one country-one duty principle. It is provided that, as regards the anti-dumping investigation against a NME, exporters, which can demonstrate that they fulfil the specific conditions in that Article, will be subject to individual duties specified for them. These conditions include the following: the freedom of foreign investors to repatriate capital and profits, independent decision-making in the export transactions, requirement for the proportion of private ownership, exchange rate conversion based on the market situation and the impracticability of anti-dumping duty circumvention. Compared to the market economy test in Article 2.7(c), the criteria for individual treatment put more emphasis on the export activities, rather than the overall economic operation, of the producers under investigation. The reason underlying this treatment lies in the ongoing economy transition process in most NMEs nowadays, which thus requires policy release from the strict fetters under the one country-one duty rule through granting a degree of flexibility in practice. However, it is merely partial in nature since the normal value continues to be calculated by the prices from an analogue country and only the export price is counted individually.<sup>671</sup>

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<sup>669</sup> Harald Wenig, 'The European Community's anti-dumping system: salient features', *Journal of World Trade*, (2005) 39, 787 – 794, p. 793.

<sup>670</sup> Tine W.A.J. Delva, 'What happens when the dragon storms the fortress? China's unique position in EU policy on trade defence instruments', *International Trade Law and Regulation*, (2007) 13, 19-29.

<sup>671</sup> Piet Eeckhout, n.36, p.16.

Granting individual treatment is nonetheless a difficult decision for the EU, especially with regard to the possibility of duty circumvention within the territory of the exporting country. If individual treatment is granted, exports could thus be channelled by the state authorities through the exporter, which has the lowest anti-dumping duty.<sup>672</sup> Again, “state interference” emerged in the centre of controversies, which has been analysed in detail earlier. The *Shanghai Bicycle Corporation* case represents a noticeable example in this regard, where, according to the Commission, the fact that the state coordinated the activities of all bicycle manufacturers in China constitutes a sign of state interference and thus led to the decline of individual treatment application.<sup>673</sup>

#### **1.4 The recent sampling practice among the market economy and individual treatment tests**

The sampling practice is established in Article 17 of the Basic Anti-dumping Regulation. It is provided “in cases where the number of complainants, exporters or importers, types of product or transactions is large, the investigation may be limited to a reasonable number of parties, products or transactions by using samples which are statistically valid on the basis of information available at the time of the selection, or to the largest representative volume of production, sales or exports which can reasonably be investigated within the time available”.<sup>674</sup> The key rationale of sampling is to balance administrative necessities to allow a case assessment in due time and within the margin of mandatory deadlines, with an individualised analysis to the best extent possible.

In the footwear anti-dumping proceeding and insofar as the market economy treatment is concerned, the EU adopted the methodology described above. In particular, it applied equally to all non-sampled companies the weighted average margin resulting from all the companies in the sample with no distinction being made between companies obtaining market economy treatment, individual treatment or NME treatment.<sup>675</sup> That is to say, the Commission did not grant

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<sup>672</sup> Sebastina Farr, ‘Individual treatment for exporters in anti-dumping cases: the China syndrome’, *International Trade Law and Regulation*, (1997) 3, 105-107.

<sup>673</sup> Case T-170/94, *Shanghai Bicycle Corporation (Group) v. Council*, [1997] ECR II-1383, para. 113.

<sup>674</sup> Article 17 Basic Anti-dumping Regulation.

<sup>675</sup> Commission Regulation 553/2006 imposing a provisional anti-dumping duty on imports of

individual assessments to all the companies requesting market economy treatment and individual treatment; instead, it verified only the submission from the sampled applicants and automatically applied NME treatment to all the non-sampled companies.

This practice represented a stark switch in the assessment approach of the EU. In the previous investigations, the EU introduced the system of desk-check analysis when a large number of requests for market economy treatment were received. Under the desk-check system, companies outside of the sample will be checked in detail on the merits of their application submitted, but will not be investigated on the spot, which would eventually result in three rates among the non-sampled companies.<sup>676</sup> For instance, in the proceeding towards certain casting from China,<sup>677</sup> on-spot investigations were carried out only at the premises of seven sampled companies. For the remaining companies, a detailed desk analysis of all information submitted was carried out; and an extensive exchange of correspondence took place with the companies concerned, where elements in their submission were missing or unclear.<sup>678</sup> In the case of the finished polyester filament apparel fabric, the similar approach was adopted and the EU further clarified that “it should be noted that simultaneous verification visits and the non- respect of the three months deadline are explained by the fact that this proceeding involved a large number of exporting producers and that the provisions on sampling could only be used with respect to dumping calculations”.<sup>679</sup>

However, the recent footwear case disclosed a contrasting position in this regard. The Commission did not consider its failure to respond individually to each claim constituted a breach of the Basic Anti-dumping Regulation; on the contrary, such practice, according to the Commission, was justified under Article 17 on the

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certain footwear with uppers of leather originating in the People's Republic of China and Vietnam, OJ, L 98, 6/4/2006, p. 3–54; Council Regulation 1472/2006 imposing a definitive anti-dumping duty and collecting definitely the provisional duty imposed on imports of certain footwear with uppers of leather originating in the People's Republic of China and Vietnam, OJ, L 275, 6/10/2006, p. 1–41.

<sup>676</sup> Folkert Graafsma and Joris Cornelis, ‘The EC Green Paper on trade defence instruments: Guillotine on anti-dumping or smokescreen for more basic predicaments?’, *Global Trade and Customs Journal*, (2007) 2, 255-263, p.262.

<sup>677</sup> Council Regulation 1212/2005 imposing a definitive anti-dumping duty on imports of certain castings originating in the People's Republic of China, OJ, L 199, 29/7/2005, p. 1–27, para. 35.

<sup>678</sup> *Ibid*, para. 35.

<sup>679</sup> Council Regulation 1487/2005 imposing a definitive anti-dumping duty and collecting definitely the provisional duty imposed on imports of certain finished polyester filament fabrics originating in the People's Republic of China, OJ, L 240, 16/9/2005, p. 1–16, para. 34.

sampling methodology. It believed that this Article, apart from the calculation of dumping margin, should equally apply where a high number of companies concerned request market economy treatment. The exceptionally high number of claims left the administration with no alternative other than to examine only those from the companies that were part of the sample. Those considerations also apply to claims for individual treatment.<sup>680</sup> In other words, the existing provision on sampling fully encompasses the situation of companies claiming market economy and individual treatment. The exporters are, by the nature of the sampling exercise, denied individual assessment and the conclusions reached for the sample, under the NME treatment, are extended to them.

This switch of approach raised considerable objections from the producers under investigation, which subsequently brought a series of litigations in the Court. The central question was whether Article 17 on sampling entitles the Commission to ignore the claims for market economy treatment and individual treatment submitted by non-sampled operators and, accordingly, to treat companies whose claims should be granted in the same way as those whose claims should not be granted.<sup>681</sup>

Among others, the judgment in *Brosmann Footwear (HK) and Others v Council* provided detailed elaboration on this issue.<sup>682</sup> Based on the fact that 141 claims from Chinese exporting producers were submitted to the Commission, the Court considered, even if it had been possible to examine them solely on a documentary basis without the necessity of verifying that data by on-site verification visits at the producers or exporters concerned, the Commission was right to find that the number of claims was manifestly too high to enable them to be examined without compromising the completion of the investigation in good time.<sup>683</sup> The Court was thus of the view that, the Commission did not exceed the discretion granted to it by Article 17 of the Basic Anti-dumping Regulation by not deciding on all the claims from the non-sampled companies, even if it might depart from a practice which the institutions followed in earlier investigations.<sup>684</sup>

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<sup>680</sup> Commission Regulation 553/2006, n. 106, para. 57.

<sup>681</sup> Case T-401/06, *Brosmann Footwear (HK) and Others v Council*; Joined cases T-407/06 and T-408/06, *Zhejiang Aokang Shoes Co., Ltd and Wenzhou Taima Shoes Co., Ltd v Council*; Case T-409/06, *Sun Sang Kong Yuen Shoes Factory (Hui Yang) Corp. Ltd v Council*; Case T-410/06, *Foshan City Nanhai Golden Step Industrial Co., Ltd v Council*, delivered on 4 March 2010.

<sup>682</sup> Case T-401/06, *Brosmann Footwear (HK) and Others v Council*, n.112.

<sup>683</sup> *Ibid.*, para. 84.

<sup>684</sup> *Ibid.*, paras. 85 and 91.

Despite the support from the Court, the extended sampling practice, from the calculation of dumping margin to the assessment of economic conditions, is highly questionable. This trend is evidently alarming since it effectively negates non-sampled companies' statutory rights to file the claim for market economy treatment and individual treatment.<sup>685</sup> As argued by the applicant in *Brosmann Footwear (HK) and Others v Council*, Article 2.7 and Article 9.5 of the Basic Anti-dumping Regulation would be rendered meaningless if, through the application of sampling, the institutions were relieved of the obligations deriving from those provisions, which, moreover, are drafted in mandatory terms and leave no discretion.<sup>686</sup>

More important, sampling under Article 17 is indeed a methodology that is, even if aimed to simplify the investigation process, essentially premised upon a valid selective, or spot, check. The underlying presumption, or the primary rationale justifying this practice, highlights the representability and similarity between the sampled companies, on the one hand, and their non-sampled counterparts subject to the same investigation, on the other. Otherwise, such practice would be in violation of the fundamental fairness for the non-sampled group, which should not be, in any event, compromised to the administrative effectiveness alleged. Without doubt, the eligibility of the sampled producers would not be sufficient if significant discrepancies in economic conditions could be identified, such as those between market economy and NME.

### **1.5 Proposals for practice improvement and legislation modification**

Based on the preceding assessment of the EU anti-dumping law, it is argued that policy amendments in the special treatment towards NMEs and economies in transition appear imperative. In the short term, there is compelling need for practice improvement that is under the discretion of the investigating authorities. Moreover, reform in the legislation shall be considered as the ultimate solution in the long run to prevent this practice from mutating into a non-tariff barrier.

First of all, the issues of clarification, transparency, as well as predictability, have

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<sup>685</sup> Folkert Graafsma and Joris Cornelis, n.107, p. 262.

<sup>686</sup> Case T-401/06, *Brosmann Footwear (HK) and Others v Council*, n. 112, para. 62.

raised most controversies between the Commission and the enterprises under investigation. For the tests of individual treatment and market economy treatment, the major problem lies in the vaguely and generically couched wording of the selection criteria. The fact that many terms in the tests are not self-explanatory entrusts the Commission substantial, maybe even excessive, flexibility in the interpretation process and thus requires detailed definition and further elaboration. As demonstrated in the *Zhejiang Xinan* case, where the Court criticised the inaccurate understanding of the Commission of the term “significant state interference”, an erroneous interpretation of the applicable legal rules could lead the institutions to a failure in taking into proper account the relevant evidence put forward by the applicant.<sup>687</sup> Moreover, the unpredictability regarding the selection of the analogue country means that an NME producer has no yardstick at which level to set prices to avoid anti-dumping duties. It can only be sure that no anti-dumping duties will be imposed on its products by not exporting or by setting an export price that is considerably higher than the price on the import market.<sup>688</sup>

Therefore, practical guidelines dealing with the wording ambiguities and clarifying the testing points are highly recommended. In the mean while, it is also essential to delineate the limits upon the interpretative discretion in the hands of the investigating authorities. Undoubtedly, the biggest beneficiary under the proposed guidelines would be the exporters from the NME. As a general rule, decisions during the EU anti-dumping proceedings are based on the “information available”; it is thus of significant importance for the exporters being investigated to submit the correct evidence required. In this regard, the introduction of guidelines could be an effective approach to avoid the inaccurate conclusion owing to lack of evidence. In the meantime, access to sufficient and reliable information could also improve the efficiency and precision of the Commission’s decision-making process.

Similar problems in clarification and transparency also emerged in the selection of NMEs, economies in transition, as well as analogue countries. With regard to the lists of NMEs and economies in transition, a periodical review becomes indispensable, which should pay particular attention to the progress and improvement lately made in those countries and entail adjustment to the lists

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<sup>687</sup> Case T- 498/04, *Zhejiang Xinan Chemical Industrial Group v Council*, n.44, para. 106.

<sup>688</sup> Joris Cornelis, n. 94, p.110.

accordingly. The assessment should explain in detail the deficiencies remaining in the economy system and the reasons for the denial of market economy status. Continuity in reports on the same country should also be guaranteed. Systemic drawbacks, which were not mentioned in the previous reports, should not be raised in the later stage against the country concerned. The Commission should enumerate and specify the entirety of the shortcomings in terms of market economy standards, rather than constantly put forward “newly-spotted” problems, unless policy retrogression indeed emerged after the last round of evaluation.

For the selection of the analogue country under the current EU regime, it is impossible for the NME exporters to foresee the potential candidate countries; moreover, once the decision is made, there is usually not enough time for them to collect the required evidence to lodge a demurral before the deadline expires. The resolution proposed here is to set up a list of analogue countries for each NME and economies in transition. The candidate countries in the list should be selected in terms of their economic comparability and similarity with the NME or economy in transition concerned. This approach would be beneficial in many ways: first, decisions made in accordance with this list would enhance the transparency of the selection process, which would also improve the accuracy and reliability of the relevant calculations. Second, it might also facilitate the Commission’s investigation process. Rather than searching for a suitable economy worldwide, the EU could instead carry out the analysis within a smaller group of countries, which may be, at the same time, the most competent and appropriate options. Last but not least, this approach would also guarantee procedural fairness for the exporters under investigation. In particular, having the relevant research in advance makes it feasible for them to submit a complaint within a short time period where the analogue country selected indeed causes incomparability and unfairness.

The second issue subject to practice improvement concerns the Commission’s approach in assessing the submission from interested parties. It has already been noted that, in some cases, the investigating authorities selected only part of the information submitted, which would probably lead to refusal of the request. In other words, it might be the case that in the test of market economy or individual treatment, the Commission fails, intentionally or not, to pay sufficient attention to the overall evidence.

In the *Zhejiang Xinan* case, the Commission believed that the establishment of the China Chamber of Commerce Metals, Minerals & Chemicals Importers and Exporters (CCCME), which involved the setting of a minimum price for glyphosate exports, violated the criterion of the independent decision-making process under Article 2.7(c).<sup>689</sup> On the contrary, as argued by the applicant in the statement submitted, the CCCME's role consisted only in verifying the contract price, entering it in a database for statistical purposes and stamping the contract when that had been done. It further explained that the stamp did not mean that the CCCME had approved the price but that the verification had taken place.<sup>690</sup> In the judgment delivered in that case, the Court agreed that the documents provided by the applicant were capable of demonstrating that the mechanism in question had not been imposed by the state, that the price was set by the glyphosate producers who were members of the CCCME themselves and that it had not entailed any actual restriction on the applicant's exports.<sup>691</sup> Therefore, it was concluded that the institutions' assessment relating to the CCCME's role was not sufficient, in view of the evidence submitted by the applicant, to arrive at the conclusion that the applicant was not able to meet in the first indent of Article 2.7(c).<sup>692</sup> In other words, certain important information had not been properly considered in the investigation process and thus the Commission failed to carry out a comprehensive and impartial assessment.

Along with the short-term improvement pertaining to practice, in the long run, legislative amendments should be expected. It has been almost nine years since the rules on special treatment were integrated into the Basic Anti-dumping Regulation,<sup>693</sup> the revision of which thus becomes imperative due to the changes in the economic structures of most third countries concerned. One may argue that it might be a pertinent moment to allow further release of the current thresholds and a potential starting point could be the switch of burden of proof. In particular, it has already been proposed that the EU should automatically award individual treatment unless the inappropriateness could be otherwise proved. Similar progress should be

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<sup>689</sup> Recital 14 Council Regulation 1683/2004, n. 54.

<sup>690</sup> Case T- 498/04, *Zhejiang Xinan Chemical Industrial Group v Council*, n. 44, para. 144.

<sup>691</sup> *Ibid*, para. 151.

<sup>692</sup> *Ibid*, para 158.

<sup>693</sup> Council Regulation 2238/2000 amending Regulation 384/96 on protection against dumped imports from countries not members of the European Community, OJ, L 257, 11/10/2000, p. 2–3.

extended into the market economy test in the later stage.<sup>694</sup> Furthermore, recourse to the analogue country should be reduced to the minimum extent possible. During a particular investigation, where market economy treatment is granted to certain exporters, data from those enterprises should be used in the normal value calculation for the remaining exporters subject to the same investigation, rather than resorting to a third country. By doing so, normal value for the Chinese producers would be decided in a way that is much more impartial and appropriate than the analogue country approach and thus considerably reduce the chance of data inaccuracy in the final outcome.

One possible approach to accelerate the legislation reform in the EU is to lodge a WTO complaint challenging the current anti-dumping practice. As discussed in Chapter II, the indirect effect of WTO law, as well as that of WTO rulings, in the area of anti-dumping has been consistently recognised, explicitly or implicitly, by the Court since the *Nakajima* doctrine. In particular, as the implementation exception to the general lack of direct effect, the legality of the contested regulation imposing anti-dumping duties should be assessed in the light of WTO rules. Therefore, if an adverse WTO ruling were delivered, the EU would be under the obligation of legislation amendments. Arguably, the situation provided under Article VI GATT is no longer the case for most of the NMEs under the EU list; thus, there would be a great chance for the listed Members to gain a favourable ruling from the WTO.<sup>695</sup> However, it is not the case as regards the treatment towards China, which is separately authorised under Section 15 of the Accession Protocol. Therefore, the only option left for China is to follow Russia's approach in negotiating a bilateral solution with the EU.

Even if it seems impossible for China to challenge the overall denial of the market economy status, it could nonetheless lodge WTO complaints regarding other issues under EU's NME methodology. The overall development of legalisation in the WTO system, in particular, the tighter obligations and greater precision of the covered agreements, provides incentives for China to litigate matters which are important to it, yet are widely perceived as "un-litigable" due to the lack of "a

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<sup>694</sup> Jan Hoogmartens, *EC Trade Policy Response—Safeguards and Market Disruption from EC Trade Law Following China's Accession to the WTO*, The Hague: Kluwer Law International, c2004, p. 176.

<sup>695</sup> Edwin Vermulst, n. 91, p. 111.

sound” textual basis in the covered agreements.<sup>696</sup> In fact, two requests have been received at the WTO thus far, where China raised objections against the definitive anti-dumping duties imposed by the EU respectively on fasteners and footwear.<sup>697</sup> This clearly indicates that China is determined to litigate the un-litigable.<sup>698</sup> It is thus interesting to see how the panel and the Appellate Body will interpret the major issues under the current EU practice, namely the analogue country approach, the one country-one duty principle and the tests of market economy and individual treatment, especially with regard to their WTO compatibility in the light of Ad Article VI GATT, Section 15 of the Accession Protocol, Para 151 of the Working Party Report and other relevant ADA provisions. The biggest obstacle for China might be the textual ambiguity and vagueness of the foregoing WTO provisions; its experience therefore shows how a relatively new WTO Member struggles to deprive benefit from the rise of legalisation in the trade regime and at the same time fights the restraints imposed by the uneven expansion of legalization.<sup>699</sup> It has already been argued that the introduction of the NME concept is producing a second class of WTO membership and the NME label offers a convenient opaque tool for pandering to selective lobbying for protection, thereby avoiding the use of more blatant and measurable protectionist policies.<sup>700</sup>

## **Section II. The EU safeguard mechanisms towards China**

This section will examine the EU TDI in the form of safeguards, which are much less frequently invoked in practice. Unlike the anti-dumping regime discussed previously, there is no EU regulation with particular focus on safeguard actions; rather, relevant disciplines are integrated into the legislation governing imports in general, such as Regulation 260/2009 on common rules for imports and Regulation 3030/93 on common rules for imports of certain textile products.<sup>701</sup> For example, Articles 16-22 of the former, which implement the WTO safeguards under Article

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<sup>696</sup> Yan Luo, *Anti-dumping in the WTO, the EU and China: the Rise of Legalization in the Trade Regime and its Consequences*, Kluwer Law International, 2010, p.156.

<sup>697</sup> [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds397\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds397_e.htm);

[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds405\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds405_e.htm)

<sup>698</sup> Yan Luo, n. 127, p.156.

<sup>699</sup> Ibid.

<sup>700</sup> Adam McCarty and Carl Kalapesi, ‘The economics of the non-market economy issue: Vietnam catfish case study’, available at <http://www.eldis.org/fulltext/vietnam.pdf>.

<sup>701</sup> Council Regulation 260/2009 on the common rules for imports (Codified version), OJ, L 84, 31/3/2009, p. 1–17.

XIX GATT and the SGA, constitute the principal EU legislation in this area.

Moreover, the EU applies a special safeguard regime to imports from China. Legislation in this regard mainly consists of Regulation 427/2003<sup>702</sup> and Article 10(a) of Regulation 3030/93, which respectively implement Section 16 of the Accession Protocol and Para 242 of the Working Party Report. The applicability of Section 16 in the T&C sector has already been analysed in the previous part. Insofar as T&C products from China are concerned, the choice between Regulation 427/2003 and Article 10(a) of Regulation 3030/93 is a policy decision falling within EU's discretion. In spite of the varying features of the safeguard actions under these two mechanisms, the EU is entitled to invoke either of them subject only to the limitation on double application.

For other industrial products, the China-specific safeguard regime does not exclude the operation of the standard WTO safeguards. As analysed in Chapter III, this is mainly due to the co-existence, and to a certain extent, co-applicability between Article XIX GATT and the SGA, on the one hand, and Section 16 and Para 242, on the other.<sup>703</sup> Therefore, depending on the extent of injury caused in the domestic industries, either "serious" or "material", recourse can be accordingly made to the WTO *erga omnes* safeguards or the special safeguards in the accession documents. The ensuing section will not commit to providing an in-depth discussion of the general WTO safeguards, which have been comprehensively scrutinised in many contributions; rather, it will focus on the EU implementation of the two China-specific mechanisms under Section 16 and Para 242.

### **2.1 The transitional product-specific safeguards**

Regulation 427/2003 implements Section 16 of the Accession Protocol and provides for a transitional product-specific safeguard mechanism (TPSSM).<sup>704</sup> Based on the provisions under Section 16, the TPSSM further elaborates on several issues to facilitate the enforcement in practice. First, Article 4 defines the term

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<sup>702</sup> Council Regulation 427/2003 on a transitional product-specific safeguard mechanism for imports originating in the People's Republic of China and amending Regulation 519/94 on common rules for imports from certain third countries, OJ, L 65, 8/3/2003, p. 1–11.

<sup>703</sup> For detailed discussion, see Chapter III Section II.

<sup>704</sup> Regulation 427/2003, n. 133.

“Community industry” as “the Community producers as a whole of the like or directly competitive products operating within the territory of the Community or those of them whose collective output of the like or directly competitive products constitutes a major proportion of the total Community production of those products”.<sup>705</sup> This is an essential definition in the EU context, which confines the investigation scope in the test of material injury and the subsequent stages related to the amount of duties. Second, Article 7 on the provisional actions specifies the meaning of “preliminary determination” which is required under Section 16.7 of the Accession Protocol: the Commission shall take such provisional measures after consultation with the Member States or, in case of extreme urgency, after informing the Member States. Furthermore, with regard to the protection of confidential information, which is missing in the text of Section 16, Article 17 establishes the requirements in accordance with Article 3 SGA. Last but not least, for trade diversion measures, Article 6 mandates the same set of investigation procedures as those for market disruption safeguards.<sup>706</sup>

However, owing to the stipulations above, especially those regarding the procedural obligations imposed on the part of the EU, Regulation 427/2003 has been criticised for not giving the maximum protection allowed under the WTO rules to the domestic industries.<sup>707</sup> It is argued that, to a certain extent, it indirectly raises the thresholds for actions under Section 16, particularly in the case of trade diversion safeguards. On this point, rather than considering such provisions as an encroachment of EU’s WTO prerogative, they could be better understood as the indispensable steps safeguarding the interests and procedural fairness of the exporters and producers under investigation. Subject to the lowered thresholds in Section 16, sufficient procedural arrangements in this regard are of significant importance to prevent potential abuse of the substantive rules. On the one hand, literal omission in the text, such as the preliminary investigation for trade diversion safeguards, does not suggest an unfettered freedom on the part of investigating authorities. Neither should these procedural insufficiencies be seen as granting a more advantageous position to the importing Members. On the other hand, due diligence of the investigating authorities, arising from the requirement of procedural

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<sup>705</sup> Ibid, Article 4.

<sup>706</sup> Analysis of Section 16 safeguard measures is provided in Chapter III Section II.

<sup>707</sup> Marco Bronckers and Martin Goyette, ‘The special safeguard clause in WTO trade relations with China: (How) Will it work?’, Marco C.E.J. Bronckers and Gary N. Horlick (eds), *WTO Jurisprudence and Policy: Practitioners’ Perspectives*, London: Cameron May, 2004, 427-438.

fairness for all the interested parties, has been consistently emphasised in WTO jurisprudence.<sup>708</sup> Thus, it is the responsibility of the WTO Members, during the implementation process, to address the procedural defects of Section 16.

Alongside the provisions in supplementation to Section 16, Regulation 427/2003 also injected several “Community features”, which include provisions on the initiation of proceedings,<sup>709</sup> decision-making procedures,<sup>710</sup> regional measures,<sup>711</sup> verification visits<sup>712</sup> and the Community interest clause.<sup>713</sup> In particular, an investigation could be launched upon the request of a Member State or upon the Commission’s own initiative. For the adoption of the action to be taken, it is the Council, by qualified majority voting, that may confirm, amend or revoke the Commission’s proposal. Under exceptional situations, the Commission may authorise the application of safeguard measures limited to certain Member States only, provided it considers that such measures applied at that level are more appropriate than measures applied throughout the Community. Furthermore, the Commission is entitled, during the investigation, to carry out visits to examine the records to verify information provided; it may also carry out investigations in third countries. Finally, safeguard measures may not be applied where the authorities can clearly conclude that it is not in the Community interest to apply such measures.

In practice so far, on only one occasion, has the EU invoked the TPSSM proceedings, which was nevertheless terminated in the early stage without any substantive action being imposed. In June 2003, Spain lodged a request with the Commission in which it highlighted the fact that imports of certain prepared or preserved citrus fruits had more than doubled in a single year and were continuing at a high level, causing serious injury to the Community producers. Having carefully examined the complaint, the Commission initiated a safeguard investigation concerning imports of canned mandarins, which was opened under both the general *erga omnes* safeguards and the TPSSM towards China.<sup>714</sup> Shortly

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<sup>708</sup> *US — Cotton Yarn*, Appellate Body Report, WT/DS192/AB/R, paras. 73-79 and 109; *Argentina — Footwear (EC)*, Appellate Body Report, WT/DS121/AB/R, paras.118 and 121; *US — Wheat Gluten*, Appellate Body Report, WT/DS166/AB/R, para. 55.

<sup>709</sup> Article 5 Regulation 427/2003, n. 133.

<sup>710</sup> *Ibid*, Article 9.

<sup>711</sup> *Ibid*, Article 10.

<sup>712</sup> *Ibid*, Article 16.

<sup>713</sup> *Ibid*, Article 19.

<sup>714</sup> Notice of initiation of (I) a safeguard investigation under Council Regulations 427/2003 and 2201/96 concerning imports of certain prepared or preserved citrus fruits (namely mandarins, etc.)

after, a preliminary investigation indicated that the conditions for the imposition of provisional measures were fully met and the Commission published Regulation 1964/2003 imposing provisional measures in the form of a tariff quota for all countries including China.<sup>715</sup> However, as indicated by the Commission, since the provisional measures imposed under the general *erga omnes* safeguard investigation were considered sufficient to protect the Community industry, no provisional measures were required on the basis of the TPSSM. The Commission also considered that it was not in the Community interest to continue with two proceedings, and as a result, investigation under the TPSSM was terminated.<sup>716</sup>

## **2.2 The EU safeguards in T&C**

The EU safeguards in the T&C sector consist of several mechanisms depending on the exporting country of the products. In general, the exporting countries were categorised into five groups: the WTO Members, certain candidate countries of the EU, countries with MFA-sponsored bilateral agreements, non-WTO Members countries with no contractual relations with the EU and, finally, China. Most T&C safeguards are set forth in Regulation 3030/93.<sup>717</sup> During 1995 – 2005, imports from WTO Members were subject to either the SGA or the transitional ATC safeguards: the former governed the categories after the GATT integration and the latter was in charge of the remaining un-integrated T&C products. This temporary arrangement terminated at the end of 2004 and the *ergo omne* WTO safeguards became the only mechanism applicable thereafter. However, China, as the newly-acceded WTO Member, stands out as a noticeable exception, the accession

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originating in the People's Republic of China and (II) a safeguard investigation under Council Regulations 3285/94, 519/94 and 2201/96 concerning imports of certain prepared or preserved citrus fruits (namely mandarins, etc.), OJ, C 162, 11/07/2003, p. 2-5.

<sup>715</sup> Commission Regulation 1964/2003 imposing provisional safeguard measures against imports of certain prepared or preserved citrus fruits (namely mandarins, etc.), OJ, L 290, 08/11/2003, p. 3 - 31.

<sup>716</sup> 2003/855/EC: Commission Decision terminating the transitional product-specific safeguard proceeding concerning imports of certain prepared or preserved citrus fruits (namely mandarins, etc.) originating in the People's Republic of China, OJ, L 323, 10/12/2003, p. 11–12.

<sup>717</sup> In particular, Article 10 of Regulation 3030/93 includes first, the basket mechanism against imports from Community's bilateral contractual partners; second, the special regimes applicable to textile imports from Bulgaria, the Czech Republic, Hungary, Poland, Romania and the Slovak Republic, which were, at the time, candidate countries for the EU membership; and third, the mechanism implementing the ATC transitional safeguard applicable to WTO Members. Moreover, Article 10 (a), which was inserted in 2003, is particularly aimed at implementing Para 242 of the Working Party Report and focuses on the special safeguard provisions for China. With regard to the exporting countries, which are neither WTO Members nor contractual partners of the EC, Article 12 of Regulation 517/94 establishes the applicable safeguard device. In fact, Article 12 applies only to North Korea and all other countries have been removed. See Annex II of Regulation 517/94.

commitments of which introduce another transitional T&C safeguard mechanism under Para 242 of the Working Party Report.

### **2.2.1 The Community implementation of Para 242**

Para 242 is transposed into the EU import regime through Article 10(a) of Regulation 3030/93. Apart from the literal transcription of Para 242, Article 10(a) further sets forth clauses on the decision-making process and the surveillance system. Concerns nevertheless arose in the EU with regard to many aspects of the enforcement, including the textual ambiguities, the need for enhanced transparency and the issue of predictability. In response, the Commission published the “Notice on the application of Article 10(a) of Council Regulation (EEC) No 3030/93 concerning a textiles specific safeguard clause” (the Guidelines) in April 2005.<sup>718</sup>

In general, the Guidelines not only specified the procedures required in order to invoke such sectoral instrument, it also elaborated on the criteria that the Commission intended to follow, clarifying under what circumstances the Commission would consider safeguard actions against textile imports from China. In essence, it stipulated the following issues: the establishment of an ‘early warning system’; the criteria for imposing the Para 242 action; the procedures for a diligent handling; and the examination of the action request. Furthermore, provisions on extreme urgency were also included.

#### ***The early warning system: alert levels***

The Guidelines established alert levels in the annexed Tables A and B for the potential import surges from China. According to this system, “should the trend of imports from China show that there are indications that a ‘disorderly development of imports’ is occurring or is imminent, and before invoking the safeguard clause, it would first ask for informal consultations with China and open an investigation on whether such imports may be causing market disruption”.<sup>719</sup> According to the quantified thresholds set forth in Tables A and B, either a rapid rise or surge in

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<sup>718</sup> Notice on the application of Article 10a of Council Regulation 3030/93 concerning a textiles specific safeguard clause (The Guidelines), OJ, C 101, 27/04/2005, p. 2 - 15.

<sup>719</sup> Ibid, Part 6.

imports, or a sudden and precipitous drop in unit value in any product category would start the early warning system.<sup>720</sup> However, these established thresholds would trigger only an investigation and informal consultations, which would not be relevant in determining whether recourse to Para 242 is justified.<sup>721</sup> Moreover, Part 7 of the Guidelines further specified the bottom levels, below which no Para 242 actions should be considered. Under these circumstances, the increased imports were the normal and expected consequence of the elimination of quotas. In sum, these quantified standards under the Guidelines to a large extent improved the clarity and the predictability of the Para 242 application.

### ***Substantive criteria triggering Para 242 actions***

The Guidelines developed four substantive criteria that would trigger Para 242 actions, namely, causes of the disturbance, threat to trade disturbance, market disruption and other relevant factors.

According to the Guidelines, the cause of the disturbance — the disorderly development of trade due to market disruption — has to be “imports of textile and clothing products originating from China and covered by the ATC”.<sup>722</sup> This criterion was closely linked to the question of how to identify the role of Chinese imports in the ongoing market disruption. It indeed corresponded to the requirement for the non-attribution test, which, although absent from the text of Para 242, should be taken into account as an implicit but compulsory prerequisite during the preliminary investigation.<sup>723</sup>

The term “threat to trade disturbance” appears for the first time in Para 242 among other WTO agreements, the meaning of which is nevertheless not clarified in the accession documents. In contrast, according to the Guidelines, this term should be interpreted in terms of the import increase in volume and the evolution of import prices.<sup>724</sup> In particular, the Commission would take as a main indicator the existence of a rapid rise or surge in imports, in either quantities or values. The increase must

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<sup>720</sup> Ibid.

<sup>721</sup> Ibid.

<sup>722</sup> Para 242 Working Party Report.

<sup>723</sup> For detailed discussion, see Chapter III Section 2.1.1.

<sup>724</sup> Part 4, The Guidelines, n. 149.

be rapid and steep, in a way that it can be considered as a significant alteration of trade patterns in a given group of products; and a small percentage change cannot be considered sufficient.<sup>725</sup> In the case where the increased imports from China could not comprise a surge in imports, another factor to be assessed would be the evolution of prices, which normally has to be calculated as average unit prices as can be determined by import statistics.<sup>726</sup> Therefore, significant drops of average unit import prices combined with such increases in imports were likely to result in market disruption and constitute a threat to the orderly development of trade.

With regard to “market disruption”, understanding under the Guidelines was mainly guided by the definition included in Section 16 of the Accession Protocol, which has been analysed in detail in the previous part.<sup>727</sup>

Last but not least, some other factors were also relevant in determining whether or not the EU should resort to Para 242 and two of them were explicitly mentioned in the Guidelines. The first one referred to the general interest of the Community, which may turn down the proposal for Para 242 actions. This is the so-called Community interests clause, the consideration of which has been widely involved in EU’s TDI application.<sup>728</sup> In short, this clause questions whether overall public interest calls for intervention from the Community.<sup>729</sup> Autonomous trade measures may only be imposed if they are not contrary to the overall interest within the EU. Therefore, it requires an appreciation of all the various interests taken as a whole, ranging from the industries, producers, importers to the end-users and consumers.<sup>730</sup> In other words, such a test ultimately boils down to a balancing of the different operators in a given market; and the term “community interest” is therefore a misnomer, which would be more appropriately called “economic balancing”.<sup>731</sup> Other factors, such as employment in the distribution sector,<sup>732</sup> competition within the Community<sup>733</sup> and trade relations with other countries, should also be

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<sup>725</sup> Ibid.

<sup>726</sup> Ibid.

<sup>727</sup> Ibid. For detailed discussion, see Chapter III Section 2.1.1.

<sup>728</sup> For detailed discussions, see Section 3.2.

<sup>729</sup> Article 21 Regulation 1225/2009, n.2.

<sup>730</sup> Ibid; Article 19 Regulation 427/2003, n.133.

<sup>731</sup> Harald Wenig, n. 100, p.791.

<sup>732</sup> I. Van Bael and J.-F. Bellis, *Anti-dumping and Other Trade Protection Laws of the EEC*, Bicester: CCH, 1990, p. 148.

<sup>733</sup> Ibid, p. 149.

evaluated.<sup>734</sup>

However, previous experience hardly saw any substantial influence, in the decision-making process, of this clause. Take anti-dumping as an example. Once dumping and injury are found and measures are likely to give relief to the complainant industry, there is a presumption that such measures would be in the Community interest.<sup>735</sup> In those cases, interests of the consumers, as well as the importers, weighed much less than the complaining industry. Since 1996, the EU authorities have gone through the motions of considering the Community interest, but in only two cases has this led them to refrain from applying dumping duties.<sup>736</sup> Therefore, even if the test sounds liberal and impressive, and is indeed often invoked by the more liberal Member States, in practice it is virtually a dead letter.<sup>737</sup>

Compared with the Community interest clause, the second testing factor specified in the Guidelines was less prevalent among the TDI practice, which nevertheless deserves specific discussion due to its highly controversial nature. In particular, Part 4 (d) of the Guidelines provided that “one factor to be considered is the impact that a surge in imports from China may have on other suppliers and in particular on the more vulnerable and textile-dependent developing countries”.<sup>738</sup>

To start with, neither the accession documents nor other WTO agreements have made reference to such a criterion. In particular, substantive thresholds under Para 242 focus exclusively on the domestic market and industries in the importing Member; and thus, consideration regarding the negative influence caused to other supplier countries essentially stemmed from the EU’s own initiative.<sup>739</sup> It is nevertheless questionable whether, in the course of domestic implementation, this additional criterion, which led to substantial changes to the multilateral disciplines being implemented, should be permitted. Indeed, it substantially lowered the thresholds for safeguard action in that, not only the EU’s own industries, it was

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<sup>734</sup> Ibid.

<sup>735</sup> Jacques Bourgeois, ‘EC anti-dumping enforcement – selected second generation issues’, in B. Hawk (ed), *Annual Proceedings of Fordham Corporate Law Institute*, Matthew Bender, New York, 563-602, p.589.

<sup>736</sup> Aubrey Silberston, ‘Anti-dumping rules – time for change?’, *Journal of World Trade*, (2003) 37, 1063-1081, p.1072.

<sup>737</sup> Ibid, p.1073.

<sup>738</sup> Part 4 (d), The Guidelines, n. 149.

<sup>739</sup> Section 16.4 Accession Protocol and Para 242 Working Party Report.

enough even if the traditional third country suppliers alone are affected and displaced.<sup>740</sup>

According to the Guidelines, “a serious displacement from the EU market of traditional suppliers can constitute a sign that trade is being disturbed and have serious negative consequences that it may be appropriate to remedy”.<sup>741</sup> The underlying rationale seems to be that the re-arrangement of market shares caused by the import surge from China was considered as a signal of market disruption. However, it is rather doubtful whether the share loss of other supplier countries equals an indication of material injury to the European industries. As the Report of Foreign Trade Association pointed out, “the only thing that is certain is that imports from China skyrocketed in a quite disproportionate fashion during the first moment of 2005...however, this was largely to the detriment of other supplier countries and in fact the increase in overall imports was a matter of just a few per cent...it is therefore evident that there was no real threat of disruption of the market”.<sup>742</sup> In other words, the causal link between market reshuffle, or concentration, on the one hand, and market disruption and material injury caused, on the other hand, could not be taken for granted.

The question also arises as to the influence of such a market reshuffle in the decision-making process, which is linked to whether the adverse influence on other third country suppliers, alone, could constitute the trigger of Para 242 action. Alternatively, it is only an element supplementary to the three major criteria analysed earlier. In other words, it is questionable whether or not the EU could invoke Para 242 exclusively on the ground of, or with the aim of, protecting other T&C exporting countries.

However, it is indeed far-fetched to argue that the inclusion of such consideration implies that Para 242 can be invoked on behalf of other countries.<sup>743</sup> The Guidelines did not permit this interpretation, according to which the existence of the displacement of market share alone is not sufficient and the major criteria are still a

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<sup>740</sup> Anna Comino, ‘A dragon in cheap clothing: what lessons can be learned from the EU-China textile dispute?’, *European Law Journal*, (2007) 13, 818-838, p. 824.

<sup>741</sup> Part 4 (d), The Guidelines, n. 149.

<sup>742</sup> Foreign Trade Association Report 2005/2006, available at <http://www.zeroegg.com/pdf/ar0506.pdf>.

<sup>743</sup> Anna Comino, n. 171, p. 824.

threat to the prevention of orderly development of trade and market disruption.<sup>744</sup> Therefore, even if the substitution of the market shares indeed existed, market disruption and threat to orderly trade development were still required and continued to be the principal standards for actions under Para 242. Therefore, the displacement, or substitution, in market shares can, at the maximum, be taken as a descriptive indicator for the potential market disruption.

### ***Procedures and timetable for Para 242 proceedings***

In the application of the Para 242 mechanism, the Commission intended to follow certain procedural rules during the relevant proceedings with the aim of guaranteeing transparency and expediency. Hence, the Guidelines were drafted to streamline the process especially during the initiation, investigation and decision-making stages.

Prior to lodging the WTO consultation under Para 242, the intra-Community procedures start by the opening of the investigation and simultaneously, the request for informal consultations with China. The initiation is based either on the request of a Member State or on the Commission's own initiative. In the former case, the so-called *prima facie* evidence would be required, including data and elements sufficiently pointing to the existence of market disruption and trade disturbance.<sup>745</sup> When the Commission was acting on its own initiative, information collected under the import monitoring system had to show that the alert levels in the "early warning system" were exceeded or there were sufficiently substantiated requests by parties, which were directly affected by market disruption. Here, the parties referred to a body or group of enterprises within the EU representative of the sector or product in question.<sup>746</sup> At the same time as the investigation was opened, the Commission would request informal consultations with China. The investigation and the informal consultations would be conducted within a deadline of 60 days.

At the end of the investigation, in the case of a positive determination on the basis of the information available, the Commission would submit a proposal of measures

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<sup>744</sup> Part 4 (d), The Guidelines, n. 149.

<sup>745</sup> Ibid, Part 5 (a).

<sup>746</sup> Ibid.

to the Textiles Committee and subsequently adopt it provided the Committee voted in favour by a qualified majority. In the absence of a qualified majority, the Commission would submit to the Council a proposal without delay, after which the Council might reject, amend or revoke it by a qualified majority. However, if the Council failed to reach a position within one month, the Commission would then be entitled to adopt the proposed measures. If the Council opposed the measure by a qualified majority, the Commission should re-examine it, and might then either make an amended proposal, resubmit its proposal, or present a legislative proposal. After the expiry of one month without a Council Decision, the Commission could adopt the act.<sup>747</sup>

The decision-making procedure above deserves further analysis, especially in comparison with the TPSSM under Regulation 427/2003. According to the latter, the Council, acting by a qualified majority, may confirm, amend or revoke the decision; if within three months, the Council has not taken a decision, the decision taken by the Commission shall be deemed revoked.<sup>748</sup> Therefore, although subject to the same voting rule of qualified majority, these China-specific devices differ from each other on the point that consent, or the approval, of the Council under the T&C safeguards is actually not required. In particular, the Commission's proposal regarding the application of Para 242 shall be automatically adopted within one month, unless the Council reject, amend or revoke the actions proposed. In the case of TPSSM, however, no measures could be taken without the Council's confirmation. Hence, in the absence of approval from the Council, the Commission could adopt a Para 242 action, but the measure proposed in accordance with Section 16 would be revoked. Even if Regulation 3030/93 and Regulation 427/2003 could be both invoked against T&C imports from China, the former indeed provided easier access and a better chance of passing the scrutiny of different Community institutions while actions under the latter could be easily blocked by the Member States with different opinions. This discrepancy would probably lead to the preference in the "policy shopping" of the Commission, as well as certain Member States being more seriously affected than others.

### *The expedited application under extreme urgency*

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<sup>747</sup> Part 3, The Guidelines, n. 149.

<sup>748</sup> Article 9 Regulation 427/2003, n.133.

The Guidelines also introduced emergency procedures in the case of a rise in imports of such magnitude that serious material injury to the EU industry was imminent. In this case, formal consultations with China could be launched without a preceding investigation. It was provided that in circumstances where delay would cause damage which would be difficult to repair, the Commission might, after a preliminary determination that imports threatened to impede the orderly development of trade, request directly formal consultations with China without an investigation, or before the investigation was completed.<sup>749</sup> Indeed, similar provisions are also established under Article 6 SGA, which is based on the so-called preliminary determination and could lead to an immediate and expedited application of action in the case of critical circumstances or extreme urgency. According to that Article, clear evidence that increased imports have caused or are threatening to cause serious injury is sufficient for immediate actions and the preliminary investigation is thus not required.

However, under the Guidelines, the issues were left open with regard to what kind of situations could qualify as “extreme urgency” and what factors should be taken into account prior to the urgent consultation request. Answers have been, to a certain extent, delineated in the Para 242 investigation of the EU initiated in April 2005. Shortly after the lifting of quotas, the Commission received evidence suggesting a risk of irreparable damage for two product categories: T-shirts (Category 4) and flax yarn (Category 115). In these two product categories, import volumes from China for the January-April period of this year rose by 187 per cent for T-shirts and 56 per cent for flax yarn compared with the same period in 2004. For T-shirts, import prices decreased by 36 per cent over the same period of time. Meanwhile, the average price of Chinese imports dropped by more than 30 per cent with the price being about one third of the average European price.<sup>750</sup> Data gathered during the investigation also pointed to a dramatic deterioration of the situation of the Community industry in terms of production, profitability and employment.<sup>751</sup>

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<sup>749</sup> Part 5(e), The Guidelines, n. 149.

<sup>750</sup> Statement of reasons and justification for the request for formal consultations with The People’s republic of China, pursuant to paragraph 5 (d) of the Notice on the application of Article 10a of Council Regulation 3030/93 concerning a textiles-specific safeguard clause, Part 4, available at [http://trade.ec.europa.eu/doclib/docs/2005/june/tradoc\\_123737.pdf](http://trade.ec.europa.eu/doclib/docs/2005/june/tradoc_123737.pdf).

<sup>751</sup> *Ibid.* In particular, the data shows a drop in production of 14 per cent and decreases in employment between 3 per cent and 7 per cent in Member States. Moreover, there are early indications of a substantial decrease in profitability in the first quarter of 2005.

Other relevant factors, including the impact on European consumers and direct causation between the import surge of Chinese products and the trade disturbance were also taken into consideration.<sup>752</sup> Hence, the Commission came to the conclusion that, in view of the above, it was clear that imports from China had caused market disruption for the categories concerned and consequently, decided to request formal consultations with China on May 27, 2005. With regard to the criteria of “extreme urgency” which were not settled in the Guidelines, the current case nevertheless indicated that at least dramatic increase in volume and decrease in price are indispensable.

Similar to the consideration on the market shares of other supplier countries, the EU inserted the provision of extreme urgency upon its own initiative without multilateral authorisation from Para 242. It is therefore questionable whether WTO Members could, under critical circumstances, skip the investigation procedure explicitly required in Para 246.<sup>753</sup> On this point, it is argued that permission for such actions shall be granted, which should nevertheless be enforced with adequate prudence. However, in any event, this argument cannot be interpreted as disregarding the investigating obligations mandated under Para 246; rather, it is merely due to the exceptional nature of the emergency, the necessity of which has already been justified and represented in other safeguard mechanisms under the SGA, the ATC, as well as Section 16 of the Accession Protocol. Nonetheless, it has to be pointed out that all these mechanisms, after the imposition of emergency measures, require the “follow-up steps” in the form of either subsequent investigation<sup>754</sup> or initiation of the formal consultations<sup>755</sup>. The underlying rationale seems to be that what has been avoided earlier needs to be compensated in the later stage. In the context of Para 242, the same rule should apply.

### **2.2.2 Para 242 actions in motion**

#### ***The Memorandum of Understanding***

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<sup>752</sup> Ibid, Part 6.

<sup>753</sup> Chapter III Section 3.1. It has been argued that in the application of Para 242, procedures under Para 246 shall be followed.

<sup>754</sup> Article 6 SGA.

<sup>755</sup> Article 6.11 ATC.

In the first half of 2005, China increased its textile exports to the EU by 45 per cent in value and by 40 per cent in volume. For products liberalised in 2005 there was an increase in China's market share of 145 per cent in volume and 95 per cent in value. This was coupled with significant falls in unit prices.<sup>756</sup> According to the Commission, serious market disruption took place in a small number of product sectors which had experienced both double-digit absolute growth in imports, a rise in Chinese imports, and steep falls in unit prices sufficient to force restructuring. In particular, ten categories witnessed very large overall rises in Chinese imports, as high as over 500 per cent in some cases.<sup>757</sup> Eight of the ten sectors saw double-digit absolute growth in imports, alongside huge growth in exports from China; and all ten sectors showed absolute growth.<sup>758</sup> At the same time, there were drops in unit value in all except five of the thirty-five products liberalised in 2005. These included drops in unit price of between 18 per cent and 60 per cent for all Chinese exports in the ten categories mentioned above, with the exception of only one product, flax yarn, where the unit price drop was 5.5 per cent.<sup>759</sup>

Therefore, the Commission, on April 24, 2005, launched investigations into nine categories of textile imports from China: T-shirts, pullovers, blouses, stockings and socks, men's trousers, women's overcoats, brassieres, flax or ramie yarn and woven fabrics flax.<sup>760</sup> Later on May 17, 2005, the Commission requested the application of the urgency procedure under the Guidelines on two categories, namely, T-shirts and flax yarn; and on May 27, 2005, the Commission initiated formal Para 242 consultations.<sup>761</sup> Such consultations were concluded on June 10, 2005 and led to a mutually satisfactory solution for all the ten product categories under investigation. The outcome of the consultations was reflected in a Memorandum of Understanding on the export of certain Chinese Textile and Clothing Products to the European Union between the European Commission and the Ministry of Commerce

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<sup>756</sup> Commission Paper 'Evolution of EU Textile Imports from China 2004-2005', available at [http://trade.ec.europa.eu/doclib/docs/2005/november/tradoc\\_126226.pdf](http://trade.ec.europa.eu/doclib/docs/2005/november/tradoc_126226.pdf). In these products China, the US and India are the only significant providers to have increased their exports in 2005. India's increase in exports by value is 15 per cent; the US's 10 per cent.

<sup>757</sup> Ibid. There has been an absolute rise in imports of T-shirts (24 per cent), pullovers (17 per cent), men's trousers (23.6 per cent), blouses (13 per cent), bedlinen (17 per cent), dresses (8 per cent), bras (12.5 per cent), table and kitchen linen (14.7 per cent) and flax yarn (59 per cent).

<sup>758</sup> Ibid.

<sup>759</sup> Ibid.

<sup>760</sup> Notice of Initiation of a safeguard investigation concerning imports of certain textile products originating in the People's Republic of China, OJ, C 104, 29/4/2005, p.21.

<sup>761</sup> Ibid.

of the People's Republic of China (MOU) of the same date.<sup>762</sup>

The general aim of the MOU is to limit specific categories of Chinese T&C exports, which were considered as the most sensitive to the EU industries. In particular, the MOU would manage the growth of Chinese imports to the EU until the end of 2008, application of which coincided in duration with Para 242; and ten textile categories of concern were controlled below the agreed growth levels until the end of 2007. As a result, quantitative restrictions were reintroduced on selected products, with the aim of achieving fully liberalised trade by January 1, 2008.<sup>763</sup> In categories not covered by the MOU, and until 2008, the EU undertook to exercise restraint in the application of its rights under Para 242.<sup>764</sup>

Rather than special safeguard actions, measures under the MOU belonged to “the mutually satisfactory resolutions” under Para 242 and thus were not subject to the one-year duration limit thereunder. Indeed, the MOU offered a wider coverage of ten products and a longer application period of three years. In return, the EU agreed to terminate the ongoing investigations and to allow China fair and reasonable growth levels over the three-year time. In particular, the growth rates under the MOU were higher than what would have been permitted under the Para 242 measures of 7.5 per cent. For cotton fabrics, bedlinen and table kitchen linen, it reached 12.5 per cent and 10 per cent for other seven categories.<sup>765</sup>

### *The border-block emergency*

However, measures under the MOU did not solve all the problems, existing or imminent. Within the EU, the MOU could not enter into effect until further legislation was adopted for its implementation. This referred to Regulation 1084/2005 amending Regulation 3030/93 on common rules for imports of certain textile products from third countries.<sup>766</sup> This implementing instrument came into

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<sup>762</sup> MOU, available at <http://ec.europa.eu/world/agreements/prepareCreateTreatiesWorkspace/treatiesGeneralData.do?step=0&redirect=true&treatyId=1123>; also see Commission Regulation 1084/2005 amending Annexes II, III and V to Council Regulation 3030/93 on common rules for imports of certain textile products from third countries, OJ, L 177, 9.7.2005, p. 19–26.

<sup>763</sup> Articles I-IV MOU. In two categories out of the ten, the EU had already launched formal WTO consultation with China: T-shirts and flax yarn.

<sup>764</sup> Article VI MOU.

<sup>765</sup> Articles I-IV MOU.

<sup>766</sup> Regulation 1084/2005, n. 193.

force on 12 July 2005 that was one month later after the conclusion of the MOU, according to which, import authorisations for goods shipped in the last month should be granted automatically and could not be denied entry for the lack of quantities within the 2005 quota. However, the import of all products shipped during that period was to be counted against the total quota amount of the same year.<sup>767</sup>

As a result, the quantitative restrictions under the MOU were immediately reached in several categories by the suddenly increased requests from the European importers within the time. Therefore, after the entry into force of that Regulation, a considerable amount of goods were blocked at the EU borders due to the unavailability of import quotas, which created unexpected difficulties for the normal conduct of trade.

On 5 September 2005, in view of the sudden filling of the quota levels, the Commission and the Chinese Ministry of Commerce proceeded to further consultations on how to deal with the problems caused by the quantities in excess of those established by the MOU, which eventually led to the conclusion of the Minutes regarding the establishment of transitional flexibility measures on the MOU (the Minutes of the MOU).<sup>768</sup> This agreement introduced amendments to the MOU in both the short and the long terms. In particular, the short-term amendments mainly concerned the resolution of the current border-blocking emergency while in the long run a complementary mechanism was established for the future implementation of the MOU.

First of all, the Minutes provided additional quantities and certain flexibility to the blocked cargoes. Both sides agreed that China and the EU should take charge in equal parts of the goods blocked at the borders.<sup>769</sup> With regard to China's share, it would be unblocked by different quota transfers agreed earlier<sup>770</sup> and the EU's share

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<sup>767</sup> Ibid, Footnote (1) in Annex V(b).

<sup>768</sup> Minutes of the MOU, available at [http://trade.ec.europa.eu/doclib/docs/2005/september/tradoc\\_124580.pdf%20sans%20signature%20bis.pdf](http://trade.ec.europa.eu/doclib/docs/2005/september/tradoc_124580.pdf%20sans%20signature%20bis.pdf).

<sup>769</sup> Article 3 Minutes of the MOU.

<sup>770</sup> Transfer of agreed quantities from 2006 into 2005 in categories 6 and 31 to clear totally the pending goods, as well as partially (up to 5 per cent of the 2006 level) for category 5; for the other categories and for the rest of the amounts needed for category 5, the amounts will be transferred from the 2005 quantities of category 2; Notice to importers, traders and industry – UPDATE, available at [http://trade.ec.europa.eu/doclib/docs/2005/september/tradoc\\_124620.pdf](http://trade.ec.europa.eu/doclib/docs/2005/september/tradoc_124620.pdf).

was served by a unilateral increase of the import levels through additional quotas.<sup>771</sup>

Second, during the subsequent implementation, the Minutes of the MOU introduced a double-checking system and inserted provisions on flexible quota transfers. According to the double-checking system, China and the EU would not issue more licences for those categories in excess of the agreed import levels, or above the levels indicated in Annex 1 of the MOU as amended by Annex 1 to these Minutes.<sup>772</sup> Both sides affirmed that the EU licence issued for goods shipped from July 20, 2005 would be conditional upon the issuing of Chinese licence and transmission of relevant data, in principle, by electronic means.<sup>773</sup> With regard to the flexible use of the quantitative restrictions on the ten most sensitive textile products, it was agreed that China could, after the confirmation from the Commission, make transfers between the levels agreed in the MOU to the extent and in the manner indicated in Annex 2 of the MOU. In particular, the flexibility provisions allowed 5 per cent of advance use, 7 per cent of carry-over, and 4 per cent of inter-category transfer among certain product categories.<sup>774</sup>

#### *The establishment of the a priori surveillance system*

According to the MOU, the quantitative restrictions thereunder were due to terminate by the end of 2007. In October 2007, the EU and China, based on a detailed analysis for each product with regard to the utilisation, agreed levels, actual trade levels, import shares, and specific category sensitivities, decided to introduce a surveillance system. It was mainly owing to the concern that there was a reasonable likelihood that most categories under the MOU could be subject to pressure in 2008 from imports originating in China.<sup>775</sup> In order to ensure the smooth transition towards a fully liberalised trade, it was thus necessary to monitor the trends of imports as much in advance as possible through an *a priori* surveillance system by means of a double checking system on these products.<sup>776</sup>

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<sup>771</sup> Ibid. Articles 2 and 4 Minutes of the MOU.

<sup>772</sup> Article 7 Minutes of the MOU.

<sup>773</sup> Article 8 Minutes of the MOU.

<sup>774</sup> Article 9 Minutes of the MOU. For definitions of the terms, see Chapter II Section 3.3.

<sup>775</sup> Commission Regulation 1217/2007 amending Annex III to Council Regulation 3030/93 on common rules for imports of certain textile products from third countries, OJ L 275, 19/10/2007, p. 16–18.

<sup>776</sup> Ibid.

In contrast to the *a posteriori* surveillance, which is mainly used for data collection and statistic purpose, an *a priori* mechanism is to prevent the imminent market disruption and consequent injury. The establishment of this system not only suggested the persisting cautious approach of the EU towards T&C imports from China, especially for the sensitive products newly released from quantitative restrictions, more importantly, it also indicated that subject to such monitoring mechanism, the EU nevertheless left open the possibility that further quotas might be introduced in the event of surges.

In fact, Chinese exporters did not use up all the quota allocations in 2007 and an import decline has occurred since then.<sup>777</sup> Compared with the import value in 2006, 2007 saw a decrease of 0.6 per cent.<sup>778</sup> This overall textile import shrink from China continued in 2008 and, compared with the corresponding period of 2007, the annual variation for the first six months this year reached -13.1 per cent.<sup>779</sup> The import decline may not be attributed only to the current economic recession, which has considerably suppressed market demand; it may also stem from the mounting costs on several fronts in the Chinese textile industry and the upward pressure on Chinese currency. Furthermore, the conventional advantage of the low-cost labour force in China is no longer competitive since, nowadays, at least seven major exporting countries in Asia can offer even lower labour costs.<sup>780</sup> Hence, 2008 passed on a signal that China is losing its competitive edge in T&C at least in the European market.

### ***Critical remarks on the EU-China textile crisis 2005***

Three elements have been raised as the principal causes of the 2005 crisis. The first one refers the over-dependence of the EU on Chinese T&C imports. Since the end of the 1990s, more and more European companies consider that outsourcing transaction could strengthen their competitive position by transferring those labour-intensive sewing activities to low-wage countries.<sup>781</sup> Therefore, the rapid growth of

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<sup>777</sup> 'Vietnam slashes prices and makes gains in the EU clothing market', available at <http://www.viet-country.com/article/vietnam-slashes-prices-and-makes-gains-in-the-eu-clothing-market/>. Indeed, China could increase its supplies of T-shirts by 94 per cent without exceeding its quota limit for 2007; in the case of trousers, China suppliers could rise by 72 per cent.

<sup>778</sup> External and Intra-European Union Trade: Monthly statistics, issue number 9/2008, Eurostat.

<sup>779</sup> Ibid.

<sup>780</sup> 'Vietnam slashes prices and makes gains in the EU clothing market', n. 208.

<sup>781</sup> Denis Audet, 'Smooth as silk? A first look at the post MFA textile and clothing landscape',

China's exports could be, to a certain extent, attributed to the increasing number of Chinese subsidiaries of foreign multinationals and the joint-venture partners who are searching for profit opportunities in an even more liberalised business environment. Foreign direct investment from the developed world, i.e. the EU, is to be made responsible for a substantial part of increased exports, owing to the fact that China is assuming a more important role in the global supply chain as a place where developed WTO Members outsource labour-intensive processes.<sup>782</sup>

The second reason is the inadequate ATC implementation of the EU and its passive attitude towards the sectoral reform in T&C. As mentioned earlier, the EU chose to first integrate those products that were not under quota, or had highly underutilised quotas, or were low-unit-value items.<sup>783</sup> It intentionally deferred the integration of the most sensitive articles, such as higher value-added items, until the end of the transitional period. Therefore, only minimal liberalisation of the items with substantial trade potential had actually taken place in the early stages of the ATC. As to the acceleration mechanism, the EU was running a back-loading policy through inflating the quota list with a large number of products on which there had never been quotas before.<sup>784</sup> Therefore, the EU managed to maintain remarkable sectoral protection in place during the ATC reform, which nevertheless gave rise to the risk of adjustment shock when the full market was completely opened on the January 1, 2005.<sup>785</sup>

On the one hand, the European enterprises, through the wide-scale direct investment in China, contributed the most in enhancing the competitiveness of the

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*Journal of International Economic Law*, (2007) 10, 267-284, p. 273.

<sup>782</sup> Huan Liu and Laixiang Sun, 'Beyond the phase-out of quotas in the textiles and clothing trade: WTO-plus rules and the case of US safeguards against Chinese exports in 2003', *Asia-Pacific Development Journal*, (2004) 11, 49-71, p. 63.

<sup>783</sup> Hildegunn Kyvik Nordås, 'The global textile and clothing industry post the Agreement on Textiles and Clothing', Discussion Paper No.5, World Trade Organization, Geneva, Switzerland, p.14. In fact, the opportunity to integrate non-restricted products had not been exhausted during the first two stages. When the third stage was reached, the opportunity to integrate products that previously had not been restricted under the MFA had been exhausted. However, the Textiles Monitoring Body observed that there was a tendency to integrate products where quota utilisation was particularly low. In the case of Canada, out a total of 27 specific constraints to be eliminated, 19 had a utilisation rate of less than 50 per cent in the year 2000, and of these six had zero utilisation rates. The corresponding figures for the EU were that out of 37 specific constraints to be eliminated, 28 had a utilisation rate of below 50 per cent, while in the United States, out of 43 specific constraints to be eliminated, 21 had utilisation rates below 50 per cent and of these the utilisation rate was zero for three quotas.

<sup>784</sup> For detailed discussion, see Chapter I Section 2.3.

<sup>785</sup> Jorg Mayer, 'Not totally naked: textiles and clothing trade in a quota-free environment', *Journal of World Trade*, (2005) 39, 393-426, p.398.

Chinese T&C industries. On the other hand, however, under the shield provided by the EU, they put much less attention upon the need for sectoral reform, as well as for self-improvement. Therefore, it is sufficient to argue that trade frictions in 2005 were caused in no small way by lack of preparation on the part of the EU.<sup>786</sup>

During the 2005 emergency, evidence of market disruption invoked by the Commission included not only the emergent situation in the EU industries and supply chains, it further contained the analysis on the market loss of other traditional T&C supplier countries.<sup>787</sup> Therefore, the third reason underlying the 2005 crisis is one of the “other relevant factors” specified in the Guidelines, namely the consideration on behalf of the traditional third-country suppliers. This intention has also been proved in the position paper delivered by the EU Trade Commissioner Peter Mandelson: “I have made clear that I would only resort to temporary safeguards if there were a massive surge of textile exports from China, which in particular threatened to cause economic and social mayhem in vulnerable developing countries losing the guaranteed access to our market that the disappearing quotas used to give them”.<sup>788</sup>

Indeed, the benefits for small exporting countries arising from import quotas against China are discernible. While the MFA undoubtedly truncated the export growth of developing countries as a whole, it also created niche opportunities for generally smaller states, which were able to take advantage of the restrictions imposed on more competitive producers.<sup>789</sup> In the EU-China context therefore, by restricting market access for the most competitive suppliers, the MOU quotas could artificially maintain market shares for certain countries that were not truly competitive; and reviving quantitative restrictions on Chinese products is of considerable significance in guaranteeing the market share of the traditional T&C exporters of the EU. However, it has to be pointed out that the interest of the third-country suppliers is a rather controversial justification for the quota imposition in the EU. As already analysed in the preceding part, nowhere in the accession

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<sup>786</sup> Anna Comino, n. 171, p. 818.

<sup>787</sup> Statement of reasons and justification for the request for formal consultations with The People’s Republic of China, n. 181.

<sup>788</sup> Peter Mandelson, ‘Rich Nations Must Do More to Help the Poor’, *Independent*, 27 December 2004.

<sup>789</sup> Tony Heron, ‘European trade diplomacy and the politics of global development: reflections on the EU-China bar wars dispute’, *Government and Opposition*, (2007) 42, 190-214.

documents and the WTO agreements is there a reference to such a criterion; the link between market share displacement and market disruption is also unclear and questionable. Furthermore, such consideration also has the effect of substantially releasing the threshold in Para 242 and thus rendering the imposition of restrictions much easier.<sup>790</sup> Therefore, this criterion worked more like a subsidy, offered by the EU, for the supplier countries losing their market shares and certainly does not seem to have neutral effects on trade. From this point of view, it would seem illogical to describe this crisis as a straightforward “north - south” trade issue, when a number of developing countries arguably had more to gain from quantitative restrictions against China than the T&C producers in the EU.<sup>791</sup>

With regard to China’s position in this crisis, positive comments have arisen from China’s undertaking of its responsibility in the world trade as an emerging economy bloc. As analysed above, it is the EU, rather than China, that should bear most responsibility for the 2005 crisis. It had more than a decade to prepare for the termination of quotas but no constructive measures were actually carried out. China should not be penalised because Europe maintained most of the quotas until the last minute instead of having a managed phase-out.<sup>792</sup> Even if the legality of the MOU could be readily justified as a mutually agreed solution under Para 242, the situation was nevertheless different with regard to the Minutes of the MOU, where China was not subject to any conventional obligation. It could thus be argued that, in searching for the resolution of the port-blocking emergency, China volunteered to undertake half the burden through transferring quotas from the following year.

### ***Section III. Summary remarks on the EU TDIs towards China***

In general, the China-specific contingency instruments under the EU TDI regime could be summarised as follows. First of all, Para 242 expired at the end of 2008, which is coupled with the termination of special T&C instruments under both WTO law and EU legislation. Therefore, textile products of Chinese origin have since

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<sup>790</sup> Anna Comino, n.171, p. 824.

<sup>791</sup> Tony Heron, n. 220.

<sup>792</sup> Oxfam Press Release, ‘Europe’s self-interested trade policies will devastate poor countries’, [http://www.oxfam.org/en/news/pressreleases2005/copy\\_of\\_pr050519\\_eu\\_trade.htm](http://www.oxfam.org/en/news/pressreleases2005/copy_of_pr050519_eu_trade.htm); ‘EC decision to block Chinese clothing is bad for development’, available at [http://www.oxfam.org/en/news/pressreleases2005/pr050406\\_ec\\_textiles.htm](http://www.oxfam.org/en/news/pressreleases2005/pr050406_ec_textiles.htm).

then been subject to the same import regime as those from other sectors. However, as analysed in the preceding discussions, the standard anti-dumping and safeguard mechanisms of the EU remain inapplicable to imports from China. Instead, the special treatment under the Basic Anti-dumping Regulation and the TPSSM under Regulation 427/2003 constitute the major EU TDIs in this regard.<sup>793</sup>

### **3.1 Policy preference of the EU among contingent trade remedies**

From a regulatory perspective, anti-dumping, safeguards, countervailing measures, as well as other measures with trade-restrictive effect, are based on rather differentiating conditions and the primary distinguishing point lies in whether the targeted import surges involve unfair, or illegal, trade practice. However, what they have in common is, first, in each case the WTO Member is authorised, where certain conditions are fulfilled, to impose trade restrictions that would otherwise be inconsistent with the core obligations under the WTO agreements. Second, the WTO tasks the importing Member with determining whether those conditions are satisfied; thus, the imposition of those measures is primarily based on the decision of the importing Member itself.<sup>794</sup> For this reason, the term “contingent trade remedy” is useful shorthand for referring to anti-dumping, countervailing and safeguard measures altogether; and in the case of the EU, the objective of the TDIs is either to remedy market distortions created from unfair trade practices by third countries or to address the serious deterioration of the situation of European producers arising from sharp and sudden import surges.<sup>795</sup> Moreover, categorising these trade instruments into the same group could also be explained from another aspect. In particular, they constitute the policy options for the importing Members wishing to manage trade, when certain market chaos, or disorder, takes place domestically owing to the competition from imports.<sup>796</sup>

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<sup>793</sup> It is submitted that anti-subsidy, as one of the TDIs, is not usually invoked towards imports from China. So far, the EU has not initiated any investigation in this area. Information available at [http://ec.europa.eu/trade/issues/respectrules/anti\\_dumping/stats.htm](http://ec.europa.eu/trade/issues/respectrules/anti_dumping/stats.htm).

<sup>794</sup> Jesse Kerier, ‘Contingent trade remedies and WTO Dispute Settlement: some particularities’, in Rufus Yerxa, Bruce Wilson (eds), *Key Issues in WTO Dispute Settlement: the First Ten Years*, Cambridge University Press, 2005, 46-62.

<sup>795</sup> ‘Evaluation of EC Trade Defence Instruments’, Mayer, Brown, Rowe & Maw LLP, available at [http://trade.ec.europa.eu/doclib/docs/2006/february/tradoc\\_127382.pdf](http://trade.ec.europa.eu/doclib/docs/2006/february/tradoc_127382.pdf), p.43.

<sup>796</sup> Chad P. Bown, ‘Why are safeguards under the WTO so unpopular?’, *World Trade Review*, (2002) 1, 47-62, p.49.

Given the common characteristics shared amongst the foregoing instruments, the unpopularity of a particular instrument may be interpreted as dependence on or preference for others. That is to say, it is not that national governments have managed to fend off the domestic protectionist pressures or that they no longer seek an escape from their GATT/WTO obligations, rather they are not doing so under the safeguard provisions; instead, they are choosing instruments, like anti-dumping measures, to relieve this pressure.<sup>797</sup>

Differences in the applicable legal framework – both domestic and international – appear to be a major factor in the choice by government of particular contingent trade policies.<sup>798</sup> Indeed, the policy preference under the EU TDI practice is the outcome of the combined elements including first, the fundamental rationales and normative standards of each instrument, and, second, the favourable or unfavourable factors under specific circumstances, i.e. the EU decision-making procedure and its special contingent provisions towards China. Therefore, in analysing EU's policy preference in TDI, the ensuing section will first engage in a normative comparison between anti-dumping and safeguards, which is followed, or furthered by the discussion on the specific factors delineating the unique features of the TDI regime that influence the choice of instrument.

### **3.1.1 Normative comparison between anti-dumping and safeguard measures**

In practice, the predominant use of anti-dumping by WTO Members is eye-catching. From 1995 to 2008, the annual anti-dumping initiation averaged around 240, ranging from 157 and 366 per year, and 2008 witnessed 208 cases. In contrast, the number of safeguard initiations during 1995 - 2008 merely reaches 168 in total.<sup>799</sup> In the case of the EU, 194 definitive anti-dumping measures were enforced during the period of 1996 – 2005, which is in striking contrast to the eight safeguard measures imposed in total.<sup>800</sup> Nonetheless, it has been argued that the EU seems at a turning point regarding the use of safeguard instrument; and after a long period of inaction, the EU has imposed three safeguard measures with more cases

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<sup>797</sup> Ibid.

<sup>798</sup> 'WTO Trade Report 2009: Trade Policy Commitments and Contingency Measures', available at [http://www.wto.org/english/res\\_e/booksp\\_e/anrep\\_e/world\\_trade\\_report09\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report09_e.pdf), p.20.

<sup>799</sup> Information available at [http://www.wto.org/english/tratop\\_e/adp\\_e/adp\\_e.htm](http://www.wto.org/english/tratop_e/adp_e/adp_e.htm) and [http://www.wto.org/english/tratop\\_e/safeg\\_e/safeg\\_e.htm](http://www.wto.org/english/tratop_e/safeg_e/safeg_e.htm).

<sup>800</sup> 'Evaluation of EC Trade Defence Instruments', n. 226, p. 35.

likely to follow in the near future. However, this argument has not been so far reflected in practice: after the imposition of the provision measures against farmed salmon in 2004, no safeguard actions have been adopted except the surveillance on the footwear from China.<sup>801</sup>

From a normative perspective, the reasons for this policy preference may be illustrated in several points. First of all, safeguards differ fundamentally from anti-dumping in that they are meant to temporarily slow down the pace of adjustment to changes in the external economic environment, whereas anti-dumping actions can be in place for as long as the dumping sale continues.<sup>802</sup> For example, the lifespan of the safeguard restrictions is usually less than three years before the retaliation-free period is due, which creates a powerful incentive for the protection-affording Member to lift the measures beforehand.<sup>803</sup> In contrast, under the anti-dumping regime, a definitive anti-dumping duty can be maintained for at least five years with the possibility of multiple extensions subject to the result of sunset reviews carried out by the competent authorities.<sup>804</sup> In many cases, the reviews do not seem to have constituted a major hurdle to preventing the prolongation of such measures.<sup>805</sup> For the sector of T&C, continuous application of the trade instrument is of significant importance, because the sectoral difficulty therein calls for a longer period for the permanent and fundamental reforms rather than the temporary trade protection, such as safeguards. Indeed, among more than 30 anti-dumping measures against China's T&C imports after its WTO accession, nearly half of them have been repeatedly applied.<sup>806</sup>

Second, with regard to the substantive threshold for action, on the one hand, Article 16 of Regulation 260/2009 requires that a safeguard measure cannot be imposed unless there is sufficient evidence proving the existence of "serious injury" caused to the domestic industry. On the other hand, the corresponding criterion under Article 3 of the Basic Anti-dumping Regulation refers to "material injury" only.

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<sup>801</sup> Commission Regulation 117/2005 introducing Community surveillance of imports of certain footwear products originating in certain third countries, OJ, L 24, 27/1/2005, p. 8–14.

<sup>802</sup> Henrik Horn and Petros C. Mavroidis, 'US-Lamb: what should be required of a safeguard investigation?', *World Trade Review*, (2003) 2, 395-430, p.398.

<sup>803</sup> Article 21 Regulation 260/2009, n. 109; Article 8 SGA.

<sup>804</sup> Article 21 Regulation 1225/2009, n.2.

<sup>805</sup> 'WTO Trade Report 2009: Trade Policy Commitments and Contingency Measures', n. 229, p.20.

<sup>806</sup> Reports of the Committee on Anti-dumping Practices under Article 16.4 of the agreement, [http://www.wto.org/english/tratop\\_e/adp\\_e/adp\\_e.htm](http://www.wto.org/english/tratop_e/adp_e/adp_e.htm).

According to the Appellate Body, “the standard of serious injury in the Agreement on Safeguards is a very high one when we contrast this standard with the standard of material injury envisaged under the Anti-Dumping Agreement, the Agreement on Subsidies and Countervailing Measures and the GATT 1994”.<sup>807</sup> Thus, the more restrictive requirement in the injury test makes safeguard measures less attractive to the importing Members.

Third, consideration on the scale of the restriction also concerns the importing Members. There is some natural pressure to prefer trade restrictions that target the most successful exporting nations whilst disregarding others.<sup>808</sup> However, a safeguard measure would have to apply across the board, reflecting principles of non-discrimination and the MFN.<sup>809</sup> Once safeguard action is decided, it will strike all import sources inevitably including some important and close trading partners. In that case, the EU will face the pressure from a much wider range of WTO Members. Therefore, this requirement clearly places any country initiating a safeguard at odds with the coalition of all the existing and potential exporters of the product concerned.<sup>810</sup> Furthermore, a formal safeguard measure could also involve importing nations in thorny negotiations with supplier countries that were not even perceived to be an important source of the “problem”.<sup>811</sup> In contrast, anti-dumping restrictions merely target the products from particular countries where the dumping sales are proved.

Fourth, safeguard measures are subject either to compensation granted to trading partners, or retaliation if there is to be any disagreement regarding the level of compensation.<sup>812</sup> In other words, safeguards are compensated through equivalent concessions in other sectors, either bilaterally prior to the imposition or unilaterally afterwards. Paragraph 2 of Article XIX GATT mandates the obligation of consultation on the importing Member, which thus has to consult with the affected exporting Members regarding the compensation for the trade losses arising from the measure proposed. In most cases, such compensation takes the form of tariff

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<sup>807</sup> *US-Lamb*, The Appellate Report, WT/DS177/AB/R.

<sup>808</sup> Alan O. Sykes, *The WTO Agreement on Safeguards: a Commentary*, Oxford University Press, 2006, p. 21.

<sup>809</sup> Article 16.5 Regulation 260/2009, n. 109.

<sup>810</sup> Petros C. Mavroidis, Patrick A. Messerlin, Jasper M. Wauters, *The Law and Economics of Contingent Protection in the WTO*, Edward Elgar Publishing Ltd, 2008, p.465.

<sup>811</sup> Alan O. Sykes, n. 239, p. 21.

<sup>812</sup> Petros C. Mavroidis, Patrick A. Messerlin, Jasper M. Wauters, n. 241, p. 465.

concessions in other sectors rather than the one in question. Furthermore, if an agreement cannot be reached through the consultation, the affected exporting Members would have the right to withdraw substantially equivalent concessions.<sup>813</sup> Therefore, an importing nation that employs a safeguard measure would always pay a price: it has to choose to offer alternative trade concessions as compensation, or to suffer retaliation through a withdrawal of tariff concessions.<sup>814</sup> In the latter case, however, a “three-year free pass”<sup>815</sup> is offered in Article 8 SGA, according to which, the right of suspension shall not be exercised for the first three years that a safeguard measure is in effect in the case of an absolute increase in imports. It is thus argued that these conditions are imposing an *ex ante* unknown price on the safeguard measure envisaged and none of them are required by anti-dumping procedures.<sup>816</sup>

Apart from the foregoing elements affecting the popularity of safeguards, in particular, the higher substantive threshold, the shortened application period, the MFN requirement and the provisions on compensation and retaliation, policy preference for anti-dumping also arises from the different standards of review at the WTO dispute settlement proceedings.

For disputes concerning safeguard measures, the standard of review refers to, as most Annex I Agreements, those established under Article 11 of the DSU. This applicability was confirmed by the Appellate Body in *Argentina – Footwear*, which ruled “the Agreement on Safeguards...is silent as to the appropriate standard of review. Therefore, Article 11 of the DSU...sets forth the appropriate standard of review for examining the consistency of a safeguard measure with the provisions of the Agreement on Safeguards”.<sup>817</sup> According to Article 11 DSU, a panel should make an objective assessment of the matter before it. As the Appellate Body indicated in *EC-Hormones*, “in our view, Article 11 of the DSU bears directly on this matter and, in effect, articulates with great succinctness but with sufficient clarity the appropriate standard of review for panels in respect of both the ascertainment of facts and the legal characterization of such facts under the relevant agreements”.<sup>818</sup>

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<sup>813</sup> Para 3 Article XIX GATT.

<sup>814</sup> Alan O. Sykes, n.239, p. 246.

<sup>815</sup> *Ibid*, p. 248.

<sup>816</sup> Petros C. Mavroidis, Patrick A. Messerlin, Jasper M. Wauters, n. 241, p. 465.

<sup>817</sup> *Argentina – Footwear*, Appellate Body Report, n. 139, para. 120.

<sup>818</sup> *EC-Hormones*, Appellate Body Report, WT/DS26/AB/R, WT/DS48/AB/R, para.116.

Therefore, so far as fact-finding is concerned, the panel's activities are always constrained by the mandate of Article 11 DSU: the applicable standard is neither *de novo* review as such, nor "total deference", but rather the "objective assessment of the facts".<sup>819</sup>

In assessing whether the competent authorities have complied with their obligations, the key elements of a panel's review have been summarised as follows. Panels must examine whether the competent authority has evaluated all relevant factors; they must assess whether the competent authority has examined all the pertinent facts and assessed whether an adequate explanation has been provided as to how those facts support the determination; and they must also consider whether the competent authority's explanation addresses fully the nature and complexities of the data and responds to other plausible interpretations of the data. However, panels must not conduct a *de novo* review of the evidence nor substitute their judgement for that of the competent authority.<sup>820</sup> In particular, a panel must find that an explanation is not reasoned, or is not adequate, if some alternative explanation of the facts is plausible, and if the competent authorities' explanation does not seem adequate in the light of that alternative explanation.<sup>821</sup> For the special T&C safeguards, principles concerning the standard of review under Article 11 DSU with respect to the SGA apply equally to a panel's review of a Member's determination under Article 6 ATC.<sup>822</sup>

Hence, as disclosed in WTO jurisprudence,<sup>823</sup> panels and the Appellate Body have applied a generally intrusive standard of review in the field of safeguards.<sup>824</sup> This intrusive approach leads to the result that the conditions in Article XIX GATT and the SGA are exceptionally difficult to satisfy in the WTO proceedings. So far, a number of WTO Members have used safeguards over the years, but none of those challenged in dispute settlement were able to justify the measures concerned; issues

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<sup>819</sup> Ibid, para. 117; *US – Lamb*, Appellate Body Report, n. 238, para. 106. In particular, it is provided that "We wish to emphasize that, although panels are not entitled to conduct a *de novo* review of the evidence, nor to substitute their own conclusions for those of the competent authorities, this does not mean that panels must simply accept the conclusions of the competent authorities".

<sup>820</sup> *US – Cotton Yarn*, Appellate Body Report, n.139, para. 74.

<sup>821</sup> Ibid, para. 106.

<sup>822</sup> Ibid, para. 76.

<sup>823</sup> *EC-Hormones*, Appellate Body Report, n. 249; *US-Cotton Yarn*, Appellate Body Report, n.139; *US-Lamb*, Appellate Body Report, n. 238; *Argentina-Footwear*, Appellate Body Report, n. 139.

<sup>824</sup> Matthias Oesch, 'Standards of review in WTO panel proceedings', in Rufus Yerxa, Bruce Wilson (eds), *Key Issues in WTO Dispute Settlement: the First Ten Years*, Cambridge University Press, 2005, 161-176.

mainly arose from the establishment of a causal link between imports and injury, and distinguishing among the sources of injury.<sup>825</sup>

However, a different situation has emerged in anti-dumping and it has been argued that the ADA circumscribes the ability of dispute settlement panels to address the complaints of exporters.<sup>826</sup> In particular, Article 17.6 ADA provides “if the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned”. Furthermore, “where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities’ measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.” Therefore, in the assessment of the facts, as well as the legal interpretation of the ADA, certain deference to the decisions of the national authorities is clearly established.

In sum, while safeguard actions would be examined thoroughly through an approach much closer to a *de novo* review, more deference and respect would be accorded to the national decision in anti-dumping. Assuming the exporting Member will bring any contingency instrument in a particular sector to the WTO for adjudication, the standards of review in the latter case appear to be much lower and, as a result, would be preferred by the importing Members.

The last factor playing a part in the choice of instruments is the political consideration of the importing Member. In political economy terms, the fact that anti-dumping measures imply that action is the result of an “unfair” trade practice on the part of foreign trade partners may make this contingent measure more attractive than one which turns exclusively on a consideration of the conditions in the domestic economy.<sup>827</sup> In contrast, safeguard measures attacking fair trade raise a harder political case for invoking such measures.<sup>828</sup> Moreover, acting against another government may also be less desirable than doing so against individual

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<sup>825</sup> ‘WTO Trade Report 2009: Trade Policy Commitments and Contingency Measures’, n. 229, p.15.

<sup>826</sup> Kenneth A. Reinert, ‘Give us virtue, but not yet: safeguard actions under the Agreement on Textiles and Clothing’, *The World Economy*, (2000) 23, 25-55, p.41.

<sup>827</sup> ‘WTO Trade Report 2009: Trade Policy Commitments and Contingency Measures’, n. 229, p.20.

<sup>828</sup> James Durling, ‘Beyond Doha: reflections on the future of trade remedies’, in Yasuhei Taniguchi, Alan Yanovich, Jan Bohanes (eds), *The WTO in the Twenty-first Century: Dispute Settlement, Negotiations, and Regionalism in Asia*, Cambridge University Press, 2007, p. 344.

firms.<sup>829</sup> This is exactly the case between safeguards and anti-dumping. While the former applies on the MFN basis, the latter involves only private companies. Hence, it is not uncommon that, in many countries, safeguards are discretionary and require a political decision for the imposition while anti-dumping cases are automatic if the legal requirements have been met.<sup>830</sup>

Therefore, following the above comparison between anti-dumping and safeguards, if they are alternative instruments giving relief from import competition, anti-dumping is clearly favoured by complaints for purely procedural but economically unsound reasons.<sup>831</sup>

### **3.1.2 The TDI attributes accelerating EU's policy preference**

The policy preference between anti-dumping and safeguards could be further explained by several elements unique to the EU TDI regime. Among others, different decision-making processes attract most attention, according to which it is indeed much easier for a proposal on anti-dumping duties to pass through the scrutiny of political institutions than the one on safeguards. In particular, a proposal on anti-dumping duties will be adopted by the Council unless it decides by a simple majority to reject it, within a period of one month after its submission by the Commission.<sup>832</sup> That is to say, insofar as the Council does not oppose the anti-dumping measures proposed, the Commission is, in most cases, entrusted with the power to enforce them within a month. However, in the case of safeguards, if a Member State refers the Commission's decision to the Council, the Council, acting by a qualified majority, may confirm, amend or revoke the decision.<sup>833</sup> The central difference lies in the fact that approval from the Council for the action proposed, which is not obligatory for anti-dumping, is explicitly required for safeguards. Therefore, the Commission may be prone to invoke the Basic Anti-dumping Regulation to bypass the red tape it might otherwise confront under Regulation 427/2003, in particular, to avoid the possibility of being declined in the Council. At the same time, those Member States, which suffer more than others from the import

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<sup>829</sup> 'WTO Trade Report 2009: Trade Policy Commitments and Contingency Measures', n. 229, p.20.

<sup>830</sup> James Durling, n. 259, p. 344.

<sup>831</sup> Petros C. Mavroidis, Patrick A. Messerlin, Jasper M. Wauters, n. 241, p. 288.

<sup>832</sup> Article 9.4 Regulation 1225/2009, n.2.

<sup>833</sup> Article 9.5 Regulation 427/2003, n. 133.

surges, would make the same policy choice in this regard.

Moreover, increased access to anti-dumping proceedings further enhances the popularity of such instrument among the EU industries and enterprises. According to Article 5 of the Basic Anti-dumping Regulation, an investigation to determine the existence, degree and effect of any alleged dumping shall be initiated upon a written complaint by any natural or legal person, or any association not having legal personality, acting on behalf of the Community industry. Therefore, apart from the investigation lodged by a Member State or based on the Commission's own initiative, request could come directly from private applicants. In contrast, similar access is not granted under the safeguard regime, which could be activated only by the Member State or the Commission.<sup>834</sup>

For imports from China, the inherent characteristics portraying the general unpopularity of safeguards also affect the application of Section 16 and Para 242 instruments. Besides, the following factors further suggest the same policy preference insofar as the products of Chinese origin are concerned. First of all, the NME treatment of China in anti-dumping investigations renders it much easier for the investigating authorities to establish the existence of dumping practice. It is thus argued that the NME treatment is the decisive reason for the disproportionately high anti-dumping cases against China and its loss in these battles.<sup>835</sup> In spite of the fact that the special safeguards under Section 16 and Para 242 bring down the substantive threshold to material injury, which is the same as required in anti-dumping proceedings, the NME treatment has further relaxed the trigger for action in the latter case.

Second, in the sector of T&C, the availability of quantitative restrictions against Chinese products also influenced the formulation of trade policies. It is recalled that most T&C restrictions imposed on the sensitive products into the EU remained untouched until 2005, which thus became the most effective and prevailing sectoral instrument for the purpose of import control. Consequently, it was not compelling for the EU to resort to the contingent protection in other forms and that is why Para 242 was never invoked until the eventual removal of all the quotas at the beginning

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<sup>834</sup> Article 16 Regulation 260/2009, n. 109.

<sup>835</sup> Xinzheng Hou, Rongming Ren, 'Cooperate or antagonize: the EU's dilemma on antidumping and safeguard measures against China', *China & World Economy*, (2006) 14, 70-84, p.79.

of 2005.

Hence, based on the foregoing observations, the continuing dominance and prevalence of anti-dumping could be easily envisaged. This is particularly the case where imports from China are accused for causing domestic injury in the WTO Members, which continue to consider China as a NME in anti-dumping proceedings. The EU, in this regard, constitutes the most outstanding example.

### **3.2 The Community interest clause**

In general terms, trade contingency measures adopted by importing Members can involve both benefits and costs. On the one hand, flexibility clauses on anti-dumping and safeguards allow governments to commit to deeper opening in a trade agreement while reducing the economic and political opposition to the agreement. On the other hand, in the absence of market failure, unnecessary trade restrictions will cause losses in the overall economic welfare. While contingency measures address injury to the industry, little or no account is taken of how the economy as a whole is affected.<sup>836</sup> For example, an anti-dumping action may raise the price that both domestic and foreign firms will charge in the domestic market, which to a certain extent penalises consumers and end-users. Also, this action might lead to a significant reduction in trade volumes. This ambiguous effect on economic welfare is particularly the case of the EU due to the increasing number of Member States and the diversity of affected parties involved. For instance, economic structures of the Member States vary from each other, which thus give rise to different, or even conflicting, policies towards the same industrial sector. Moreover, while manufacturing industries are generally in favour of the TDIs against the competition from the third countries, consumers and end-users, which benefit most from the low-priced imports, usually have a strong position against domestic trade protection.

The above phenomenon necessitates a comprehensive assessment on “public interest”, which however has never been used in the WTO agreements on contingent trade protection. The absence of relevant provisions in this regard

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<sup>836</sup> ‘WTO Trade Report 2009: Trade Policy Commitments and Contingency Measures’, n. 229, p.22.

reflects the lack of consensus among WTO Members on the following issues: first, which domestic parties' interest should be considered; second, what economic factor should be taken into account and how investigating authorities should weigh them; and third, what kind of procedure should be inserted into national legislation to allow the interest of various parties to be considered.<sup>837</sup>

Even though it does not constitute a compulsory WTO obligation, the EU has consistently applied the public interest test in an elaborate and systematic way.<sup>838</sup> Indeed, the Community interest clause is widely mandated under the TDI regime. As the Preamble of Regulation 260/2009 stipulates, "it falls to the Commission and the Council to adopt the safeguard measures required by the interests of the Community. Those interests should be considered as a whole and should in particular encompass the interests of Community producers, users and consumers".<sup>839</sup> For anti-dumping, Article 21 of the Basic Anti-dumping Regulation also establishes the similar requirement.

The main function of the Community interest clause is to prevent the contingency measures under consideration from being adopted if they are not in accordance with the overall EU interest. According to this clause, all TDIs should be scrutinised and subject to thorough economic impact assessments to ensure that they serve the interest of European consumers and enterprise; a TDI should be declined if the result of this test shows otherwise, despite a finding that the imports concerned have caused injury to the Community industries. It is thus required to compare the domestic interests that are hurt by the TDI with the interests that benefit from the same measure. In most cases, this clause has served as a proportionate review, i.e. Community institutions check whether the imposition of measures would place a disproportionate burden on economic operators other than the Community industry.<sup>840</sup> Therefore, it ultimately boils down to a balancing of the economic interests of the different operators on a given market, namely exporters, importers, users and consumers.<sup>841</sup> For imports from China, towards which more restrictive TDI rules are applied, a positive use of this clause might effectively reduce the

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<sup>837</sup> Yan Luo, n. 127, p.134.

<sup>838</sup> Adina Sinnaeve, 'The 'Community interest test' in anti-dumping investigations: Time for reform?', *Global Trade and Customs Journal*, (2007) 2, 157-181, p. 157.

<sup>839</sup> Preamble Regulation 260/2009, n. 109.

<sup>840</sup> Harald Wenig, n. 100, p. 791.

<sup>841</sup> Ibid.

chance of biased decisions, which would cause injury on both the EU and the Chinese sides. This is especially the case in terms of the long-time neglected economic loss suffered among European consumers.

The ensuing discussion will examine the Community interest clause in the context of anti-dumping. First, compared with the generic requirement mentioned above in safeguards, Article 21 of the Basic Anti-dumping Regulation introduces more elaborate instructions in this test; second, there is much more experience and practice in anti-dumping than TDIs in other forms. However, it does not suggest an approach exclusively applicable to anti-dumping; instead, this test should be applied across all the TDIs alike.

According to Article 21, the need to eliminate the trade distorting effects of injurious dumping and to restore effective competition can be found at the epicentre of the test and shall be given special consideration. It highlights an appreciation of all the various interests within the Community requiring that a determination on Community interest shall be made only where all parties have been given the opportunity to make their views known. As a result, Article 21 further sets forth procedures for the submission of evidence, hearing requests, as well as comments on the measures enforced.<sup>842</sup>

The text of Article 21.2 deserves particular attention, which provides “measures, as determined on the basis of the dumping and injury found, may not be applied where the authorities, on the basis of all the information submitted, can clearly conclude that it is not in the Community interest to apply such measures.” This Article indicates that, first, it is a decision of discretionary nature which emanates from the specific wording of “may not”, rather than shall not or should not. Second, this is a decision based on the information provided by the interested parties. Third, impliedly, this is a negative decision under the presumption that measures shall be applied whenever dumped imports caused material injury to the industries unless compelling evidence shows otherwise.<sup>843</sup> That is to say, the legislature believes that anti-dumping duties should be imposed wherever dumped imports caused material injury to the Community industries; only if it could be concluded from the

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<sup>842</sup> Article 21 Regulation 1225/2009, n.2.

<sup>843</sup> Yan Luo, n. 127, p.136.

information submitted that the measures would not be in the global interest of the Community, this test would provide the legal basis for not acting.<sup>844</sup> To decline such measures, a finding is required that the negative impact on certain interested parties such as users, importers or consumers, would be clearly disproportionate to any advantages given to the Community industries and its suppliers by the imposition of measures.<sup>845</sup>

With regard to the scope of the interested parties, Article 21.2 identifies the following groups: the complainants, importers and their representative associations, representative users and representative consumer organisations. Although the list is non-exhaustive, Article 21.2 makes it sufficiently clear that only parties with an economic interest in the product under investigation are meant to be part of the analysis.<sup>846</sup> Therefore, the eligibility of consumers and consumer organisations was called into question under certain circumstances, especially when the products under investigation are not commonly sold at the retail level.

In *BEUC v Commission*, the Commission claimed that only organisations representing consumers of the product involved in the antidumping proceeding can be regarded as consumer organisations for the purposes of that proceeding; and, in the case of unbleached cotton fabric, which is not commonly sold at the retail level, there are no consumers, only users.<sup>847</sup> The Court, however, expressed a different point of view: “in order to be considered an interested party for the purposes of an antidumping proceeding, it is necessary to prove that there is an objective link between the party's activities, on the one hand, and the product under investigation, on the other...the Commission does not have grounds for automatically excluding consumer organisations from the circle of interested parties by applying a general criterion such as the distinction between products sold at the retail level and other products. The Commission must decide on a case-by-case basis whether a party should be considered an interested party in the light of the particular circumstances of each case.”<sup>848</sup> Therefore, in the cases not dealing with consumer products, consumer organisations are not automatically an interested party but cannot

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<sup>844</sup> Adina Sinnaeve, n. 269, p. 158.

<sup>845</sup> Ibid.

<sup>846</sup> Ibid.

<sup>847</sup> Case T-256/97, *Bureau européen des unions des consommateurs (BEUC) v Commission*, [2000] ECR II-101, paras 47-49.

<sup>848</sup> Ibid, paras 75-76.

automatically be excluded either. They will have to show on a case-by-case basis the objective link with the product concerned, for example by demonstrating the likely effect of a cost increase of the product concerned on the price of the further processed products which are sold at retail level.<sup>849</sup>

With regard to the application in practice, the Community interest clause is indeed hardly used to reject anti-dumping measures where dumping and injury have been established. On the contrary, it is typically used to reinforce the case in favour of anti-dumping proposals.<sup>850</sup> Practice shows that a clear disproportionality finding is relatively rare; indeed, in the vast majority of cases, the positive effects of measures for the Community industries outweigh the possible negative effect on, for example, users and consumers.<sup>851</sup> Indeed, the position and interests of the Community industries that lodged the anti-dumping complaint are much better counted than those of users and consumers.

Three factors might explain this unbalance. First, compared with the end-users and consumers in Europe, the number of producers is rather limited. This small number considerably facilitates the readiness for coalition. Thus, in anti-dumping proceedings, it is much easier for the producers to carry out well-organised actions than for the consumers and the end-users with opposite interests.<sup>852</sup>

Second, experience shows that information collection constitutes the major difficulty to perform a detailed interest analysis on the users and consumers. The degree of cooperation from these groups is often poor, which rarely respond to the Commission's questionnaires. The low rate of participation has been sometimes interpreted as implying that the measures in question are not contrary to their interests.<sup>853</sup> This weak incentive to respond is partially caused by the minimal economic loss suffered by each individual party. In particular, the total cost of the anti-dumping measures tend to be distributed across a large number of private

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<sup>849</sup> Adina Sinnaeve, n. 269, p. 159.

<sup>850</sup> André Sapir, 'Some ideas for reforming the Community anti-Dumping instrument', paper presented at the Seminar on Trade Defence Instruments organized by EU Trade Commissioner Mandelson, 11 July 2006, Brussels.

<sup>851</sup> Adina Sinnaeve, n. 269, p. 159.

<sup>852</sup> Edwin Vermulst, n. 91, p.112.

<sup>853</sup> Patrik Svensson, Martin Hvidt Thelle, 'Economic assessment of the Community interest in EU anti-dumping cases', available at [http://www.copenhageneconomics.com/Files/Filer/Publikationer/Copenhagen\\_Economics\\_-\\_Economic\\_Assessment\\_of\\_the\\_Community\\_Interest.pdf](http://www.copenhageneconomics.com/Files/Filer/Publikationer/Copenhagen_Economics_-_Economic_Assessment_of_the_Community_Interest.pdf).

parties; consequently, although the cumulative effects might be significant, the adverse influence on each participant remains so marginal that it is usually neglected. The exclusion of the cumulative calculation of these marginal impacts for all the users and consumers is considered as an obvious methodological drawback in the assessment of Community interest.<sup>854</sup>

Third, another factor responsible for the low rate of participation lies in the short time limit for responding. Normally, when the Commission launches an anti-dumping proceeding, a notice of initiation is to be published in the Official Journal, which, apart from the general introduction of the complaint received, also stipulates rules and procedures regarding the submission from the interested parties. All interested parties, if their representations are to be taken into account during the investigation, must make themselves known by contacting the Commission, present their views and submit questionnaire replies or any other information within 40 days of the date of publication. This time limit is pivotal in that the exercise of most procedural rights required in the Basic Anti-dumping Regulation depends on the party's response within this period.

However, this pressing period of 40 days renders the anti-protection groups, i.e. end-users and consumers, at a markedly disadvantageous position while leaving the interest of the pro-protection groups, i.e. industries and producers, mainly untouched. For the former, it is extremely difficult to collect the evidence as required. Not only because they have to prove, with sufficient information, the objective link between their activities and the product under investigation; more importantly, any information submitted will be taken into account only if supported by factual evidence upon the submission. In contrast, such data has been well prepared by the industries before initiating the complaint at the very beginning. Therefore, it is no wonder that users and consumers rarely respond to the invitation to make themselves known and provide information to the Commission, especially since the time limit is extremely short.<sup>855</sup>

The above problems are closely linked to the issue of burden of proof in the quasi-judicial proceedings such as the anti-dumping investigation. For the defence of the

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<sup>854</sup> Ibid.

<sup>855</sup> André Sapir, n. 281.

Commission, it has been argued that it is up to the interested parties to put forward concerns in relation to the Community interest. The investigating authorities are not in the position to come up with such concerns out of their own wisdom but have to reply to what the parties bring to their attention.<sup>856</sup> Contrary to this argument, however, as the major policy executive, the Commission is under the obligation to ensure that the measures proposed or enforced by it are beneficial in terms of the overall economy and development of the EU. Rather than exclusively relying on the submission from the interested parties, the burden of proof under the Community interest test should be at least partially afforded by the Commission acting as the principal investigating authority. As Article 21 specifies, a determination cannot be made unless an appreciation of all the various interests taken as a whole has been completed. Therefore, in the case of a muted response from the interested parties, the Commission should nonetheless continue the data collection on its own initiative to complete a comprehensive assessment as required, especially with regard to the cumulative effects of the marginal impacts on individual parties; the current practice of simply interpreting it as the absence of economic loss or conflicting interest should be abandoned.

On limited occasions, the negative impact on the users and consumers were so overwhelming that left the Commission no choice other than terminating the ongoing proceeding. A typical disproportionate case refers to the situation where it is found that the Community industry is not viable anymore, and that even the imposition of measures could not be expected to allow its return to viability.<sup>857</sup> In the *PSF* case,<sup>858</sup> the following observations eventually led to the termination of the investigation:

“The overall advantages to be gained by the Community industry must be weighted against the probable disadvantages, in particular for users and, to some extent for consumers. The volume and the variety of supply offered by Community producers are deteriorating. This is due, among other reasons, to the industrial conversion of Community producers from PSF to other products (for example *la Seda de Barcelona*) and the financial difficulties of Tergal. There is a supply problem in the

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<sup>856</sup> Harald Wenig, n. 100, p. 791.

<sup>857</sup> Adina Sinnaeve, n. 269, p. 159.

<sup>858</sup> Commission Regulation 2005/2006 imposing provisional anti-dumping duties on imports of synthetic staple fibres of polyesters (PSF) originating in Malaysia and Taiwan, OJ, L 379, 28/12/2006, p. 65–94.

Community market for certain types of fibres and the Community producers cannot or are not willing to make the necessary efforts to meet the demand. Furthermore, it is likely that the imposition of duties will lead to substantial price increases of certain types of PSF, which are not available in sufficient quantities in the Community. Moreover, account should be taken of the fact that certain users of PSF (in particular the bedding industry) have very low profit margins and will have to pass on to consumers any price increase in PSF or abandon their activities in case competition from third countries would not allow them to increase their prices.”<sup>859</sup>

Furthermore, several recent proceedings bring about new debates on the Community interest test. In essential, it is argued the determination of the overall economic interest has become more complex as a result of changes in the structure of both the global and EU economies.<sup>860</sup> This has been evidently demonstrated in the investigation towards footwear imports from China and Vietnam,<sup>861</sup> where the significant economic loss suffered by the European companies engaging in outsourcing manufacture, as well as the importers and consumers, rendered the anti-dumping measures with significant adverse consequence on the EU and raised the challenge towards the traditional understanding of the “Community interest”. The classic presumption that the anti-dumping measures to the benefit of the Community producers might not have a disproportionately negative impact on other economic operators would no longer be appropriate today; and in the current economic reality, Community producers do not constitute a single, homogeneous category, sharing the same interest, anymore, but a mixture of various types of producers with different interests.<sup>862</sup>

In the mean while, another proposal on flexible enforcement of this test has also been put forward. Under the current practice, if it is shown that the proposed measure is not in line with the Community interest, it should not be applied even if the dumping and injury tests have revealed positive results. Thus, failure in this test would directly point to rejection of the action proposed. Enforcement flexibility suggests a more adaptable approach. In particular, the outcome of this test should

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<sup>859</sup> 2007/430/EC: Commission Decision terminating the anti-dumping proceeding concerning imports of synthetic staple fibres of polyesters (PSF) originating in Malaysia and Taiwan and releasing the amounts secured by way of the provisional duties imposed, OJ, L 160, 21/6/2007, p. 30–34, para.40.

<sup>860</sup> Adina Sinnaeve, n. 269, p. 157.

<sup>861</sup> Commission Regulation 553/2006; Council Regulation 1472/2006, n. 106.

<sup>862</sup> Adina Sinnaeve, n. 269, p. 157.

not be limited only to the approval or repeal of an action proposal; it should also evaluate whether the Community interest calls for specific modalities of actions, or in analogy to the lesser duty rule, for the imposition of lower duties.<sup>863</sup> This broader application of the Community interest test would imply that the Commission always has to assess whether a less restrictive measure is more favourable in the Community interest than a more restrictive one.<sup>864</sup> This is particularly the case where the balance of interest is not so clear-cut and a different lower level of the duties might alleviate their negative impact on certain economic operators.<sup>865</sup>

In sum, the Community interest test is a valuable practice of the EU in the implementation of WTO contingency instruments. It is particularly the case in terms of the diverse and complex interest allocation within the EU, the prevention of abusive use of TDIs and the requirement for administration fairness. For future improvement, it is essential to encourage active participation from the consumers and end-users, to highlight the collective negative impact on them, as well as to attach sufficient weight to the interests of outsourcing companies and importers. Improved practice might preclude many TDIs from being adopted; however, it in the meanwhile effectively raises the fairness and transparency of the investigation and precludes those TDIs with adverse consequences on both the exporting and the importing countries.

## ***Chapter conclusions***

China has been the biggest importing source and the most frequent anti-dumping target of the EU.<sup>866</sup> As the most popular TDI in EU's import control, there are three possible investigating approaches towards products from China, which render the anti-dumping proceedings highly complicated and raise doubts upon the fairness of the outcome and the excessive discretion of the investigating authorities.

The latest EU development regarding China's market economy status is not promising. On the one hand, according to the Commission Staff Working Document

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<sup>863</sup> André Sapir, n. 281.

<sup>864</sup> Ibid.

<sup>865</sup> Adina Sinnaeve, n. 269, p. 177.

<sup>866</sup> Statistics are included in the Annual Anti-dumping Reports, available at [http://ec.europa.eu/trade/issues/respectrules/anti\\_dumping/legis/index\\_en.htm](http://ec.europa.eu/trade/issues/respectrules/anti_dumping/legis/index_en.htm).

issued in September 2008, China's economy is a modern and increasingly market-based system and there is evidence of clear progress under the outstanding market economy criteria. On the other hand, despite China's efforts to reduce state interference in the management of the economy, distortions that directly or indirectly affect the domestic cost and price structure remain prevalent.<sup>867</sup> The conclusion is that China now has in place almost all the legislation which is necessary for the grant of market economy status and the focus has switched to the effective implementation of these laws, which are crucial for the functioning of any market economy. In terms of specific criteria, China has clearly fulfilled those relating to the absence of state intervention in enterprises linked to privatisation and the absence of NME forms of exchange or compensation such as barter trade; however, it fails to meet the requirements concerning the use of appropriate modern accounting standards, concerning bankruptcy, intellectual property and property laws, concerning governmental intervention in the allocation of resources or business decisions and concerning the existence of a financial system independent from the state.<sup>868</sup>

In the meanwhile, individual treatment that represents an exception to the one country-one duty rule and to a certain extent releases the strict fetters of the NME approach is in most cases requested by the Chinese exporters as the second-best option. However, according to the Court, it is extremely difficult to verify whether a Chinese undertaking really is independent from the State,<sup>869</sup> and the main worry of the EU is the possibility of duty circumvention. It has already been proved in practice that once the Commission detected the existence of circumvention, it would immediately overturn the previous decisions on the basis of "subsequent changes in factual situation".<sup>870</sup>

Hence, the NME treatment remains the EU's major investigating method so far, which is characterised by the analogue country approach in the calculation of dumping margins and the one country-one duty principle in the imposition of duties. Improvements and reforms in this regard are imperative, which, as discussed in the preceding parts, should mainly focus on the issues such as clarification,

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<sup>867</sup> Commission Staff Working Document, n. 8, p. 26.

<sup>868</sup> Commission Staff Working Document, n.8, p. 4.

<sup>869</sup> Case T-170/94, *Shanghai Bicycle Corporation (Group) v. Council*, n. 104, para. 112.

<sup>870</sup> Regulation 215/2002, n. 83.

transparency, and predictability, with the aim of further relaxing the restrictions and correcting some biased practice.

In the field of safeguards, as Para 242 came to an end in 2008, the current EU regime demonstrates the coexistence and simultaneous application of the SGA and Section 16, which entitle the EU to resort to any of the mechanisms against imports from China.

In practice, the operation of Para 242 actions successfully defused the textile crisis in 2005. No questions have been raised regarding the WTO-compatibility of the resolutions under the MOU and the subsequent Minutes thereof, these actions can nevertheless be challenged by the double-standard trade practice of the EU. On the one hand, the EU has been consistently pressing China on the issue of market opening in areas like services and investments. On the other hand, it would not hesitate to set up hurdles against exports from China once its market and industries so demanded. With regard to the interests of other supplier countries, EU's approach of preserving guaranteed market shares for small exporting countries has not been well founded under the WTO disciplines, especially when such actions infringe the trading rights of other WTO Members and result in economic loss to them.

Since the MFA, EU's T&C safeguard regime towards China has not witnessed substantial changes and indeed, it has kept in place a fairly similar system for almost 30 years. In spite of minor policy discrepancies, there are remarkable similarities between the basket mechanism under the MFA and the mechanism under Para 242: they both belong to the safeguard devices with quantified threshold ceilings upon import volume; they are both equipped with immediate VER actions on the part of China and definite EU quotas after the consultation period; furthermore, both systems are exempted from compensation for, or retaliation from, Chinese exporters. To a large extent, Para 242 could thus be regarded as an extension of the MFA basket mechanism in the context of the WTO, at least from the perspective of practical operation. However, this long-lasting safeguard practice came to an end at the end of 2008 and afterwards, a more WTO-based device under Section 16 becomes the only applicable instrument. Although this WTO-minus mechanism still in many ways deviates from the SGA and thus imposes more

restrictions upon Chinese products, it is indeed a significant step forward in terms of the sectoral liberalisation in T&C. Compared with Para 242, improvements brought in by Section 16 are manifest in the following areas.

To begin with, mutually satisfactory solutions in the form of bilateral agreements, such as the EU-China MOU concluded in 2005, are no longer permitted. According to Section 16.2 of the Accession Protocol, even in the case of the common recognition of the necessity of action, the negotiating parties are not free to choose whatever resolution they consider appropriate and the only option appears to be the self-restriction taken by China. Furthermore, even if quantitative restrictions, as a form of safeguard actions, remain available under Section 16, quotas after 2008 are not the same as those under the MFA and the MOU. The major distinction lies in the possibility of retaliatory action from China if the quotas are maintained in force beyond a certain period of time. In particular, China is entitled to suspend the application of substantially equivalent concessions or obligations under GATT 1994 to the trade of the WTO Member applying the measure, if such measure remains in effect for more than two years as a result of a relative increase in the level of imports and three years in the case of an absolute increase.<sup>871</sup>

The popularity of anti-dumping over safeguard actions is clearly established in WTO practice. The advantages of anti-dumping, according to the WTO rules, include the longer application duration, the released threshold in the injury test and the exemption from compensation and retaliation. Moreover, the limited but more focused target under restriction and the lowered standards of review at the dispute settlement also enhance the preference for such measures. These regulatory advantages have been further complemented in the EU TDI regime. Compared with the legislation on safeguards, the Basic Anti-dumping Regulation introduces simplified procedures in complaint lodging and the decision-making process, which, as a result, facilitates access to this instrument to a large extent.

In the context of EU-China trade relations, the NME treatment further contributes to the prevalence of anti-dumping. The permissive discretion of the Commission under this treatment and the restrictive interpretation of the criteria under Article

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<sup>871</sup> Article 16.6 Accession Protocol.

2.7(c) have been both supported by the Court in its early judgements<sup>872</sup> whereas recent case law discloses a noticeable move towards the tightened power of the Commission.<sup>873</sup> However, it is still difficult to envisage, at the current stage, whether more legal actions will be raised from the exporters, or whether it will bring about changes to the approach in future investigations.

The Community interest test has been mandated in most TDI decisions of the EU, which is designated to prevent actions with limited benefits but more detrimental aftermath in terms of the overall Community interests. However, it has been argued that this test failed to fulfil this target and has so far blocked the adoption of action in only a few cases. This is mainly due to the fact that, compared with the pro-protection group, i.e. the manufacturers and the industries, the anti-protection group consisting of the consumers and the end-users has been much less involved in the test. Reasons for this inactive participation include the scattered economic gains on an individual basis, the innumerable amount of interested parties and the pressing short time-limit for submission. The expected improvements shall thus focus on a shared burden of proof between the investigating authorities and the interested parties, as well as a more flexible enforcement comprising not only simple approval or denial of the action proposed but also the specific modalities thereof, such as a lower level of duties.

It is clear from the foregoing discussion that autonomous discretion plays a significant role in the EU's application of contingency instruments towards China, which has also been addressed as the WTO-plus features characterising the TDI regime.<sup>874</sup> In general, such discretion could be summarised in three categories. The first group refers to the "interpretative flexibility" where the WTO merely establishes abstract guidelines and principles and cannot be enforced without further specification. A typical example is the NME treatment under the Basic Anti-dumping Regulation implementing Ad Article VI GATT and Section 15 of the Accession Protocol. Multilateral disciplines in this regard only grant permission for the use of special methodologies; it is thus the Basic Anti-dumping Regulation that eventually fleshes out the operational system under the domestic regime.

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<sup>872</sup> Case T-35/01, *Shanghai Teraoka Electronic v Council*, n.40.

<sup>873</sup> Case T- 498/04, *Zhejiang Xinan Chemical Industrial Group v Council*, n.44.

<sup>874</sup> Yan Luo, n. 127, p.127.

The second category of the discretion lies in the establishment of the “supplementary devices” that are essential for domestic implementation but are not required, or even mentioned, under the WTO agreements. For instance, apart from literally translating the ADA, the SGA, as well as the transitional mechanisms under the accession documents, the EU legislation further specifies procedural and substantive requirements for the investigation and the decision-making process, issues such as complaint lodging and voting rules. As analysed earlier, even if it is the WTO disciplines mentioned above that dominate the policy preference among different TDIs, autonomous provisions under the “supplementary devices”, subject to different extent of procedural convenience provided, also play a role in the choice of instrument.

The last group of discretionary TDI rules arises from the “autonomous initiatives”, which are exclusively based on the particular demands of the EU without explicit WTO indication. The Community interest test is the most outstanding instance and another example can be found in the 2005 textile crisis, where the application of Para 242 safeguards was actually required for the need of other small exporting countries in the European market. It nevertheless has to point out that although the development aim constitutes a significant part of the EU policy, its WTO justification, particularly in the context of Para 242, remains unclear.

On the one hand, the autonomous discretion summarised above not only enables the EU to retain certain control over the transitional contingent policy, it also allows it to achieve the interest balance among different domestic groups. On the other hand, these WTO-plus features nevertheless witness most system deficiencies in EU’s application of the transitional contingency instruments, which therefore give rise to the need for improvement in both the practical and legislative terms. Furthermore, the problems that have emerged in the implementation process have also indicated the absence of sufficient control from the transitional mechanisms that is arguably the outcome of the textual brevity and regulatory ambiguity thereunder. Indeed, the permissive approach at the WTO cannot be simply interpreted as boundless autonomy entrusted to the Members. On the contrary, it should be supervised by the multilateral disciplines, which, even if not specified under the transitional mechanisms, constitute the fundamental principles underlying the WTO operation of trade remedies, i.e. the principles of due diligence and procedural fairness

inherent in the ADA and the SGA.

## CONCLUDING REMARKS

The foregoing analysis illustrates the contingent protection systems under selected GATT/WTO transitional mechanisms and their implementation at the national level. Through an elaborate study in the EU-China context, the following observations will conclude this thesis.

The first one concerns the choice of contingency instrument in the importing country. It is argued once domestic demands for import control arise, the importing country is inclined to act upon the most accessible instrument at the least cost subject to its international commitments. The original policy aim specified at the GATT/WTO, i.e. the anti-dumping against unfair trade practice and the safeguards against unexpected import surge, is not always the only, or even the major, determinant in the domestic decision-making process.

Quantitative restrictions, which have been conventionally outlawed under the GATT/WTO but temporarily maintained in certain sensitive sectors,<sup>875</sup> have exerted considerably influence in the choice of trade instrument. For the importing country, the handiness of import quotas, which are usually established through bilateral agreements, appears manifest in many ways. In contrast with the contingency instruments of the similar trade-restrictive effect, the major advantages of such restrictions lie in the exemption from the preliminary investigation and the obligation for compensation. Therefore, subject to the availability at the multilateral level, import quotas are generally considered as the least costly instrument in import control.

Among different instruments of contingent protection, there is striking prevalence of anti-dumping over the others, i.e. safeguards and anti-subsidy actions. The predominance can be explained by many elements including how easy it is to invoke the measure, the possibility of discriminating among sources of imports, whether the period of applicability of a measure may be extended, reputation costs, and the necessity or otherwise of providing compensation upon the adoption of a contingency measure.<sup>876</sup> The related WTO provisions regarding these issues have

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<sup>875</sup> The most outstanding instances include the T&C and the agricultural products.

<sup>876</sup> 'WTO Trade Report 2009: Trade Policy Commitments and Contingency Measures', p.22, available at

been analysed in the preceding chapter; it is thus not difficult to understand the practice in most Members to use anti-dumping measures as a substitute for safeguard actions for dealing with industries in difficulty.<sup>877</sup>

Policy evolution under the transitional mechanisms substantiates this observation in practice. Until 1995, international trade in T&C experienced a wide use of quantitative restrictions and anti-dumping actions, which, taken together, rendered other instruments essentially insignificant, including the safeguard mechanisms equipped with specific sectoral target, lowered thresholds and selective application. Shortly after the flat prohibition of T&C quotas, the EU and the US initiated a wave of T&C safeguards against China under Para 242 of the Working Party Report. The underlying rationale is Para 242, which provided obvious procedural convenience and swift action enforcement, offered the importing country a more advantageous position than anti-dumping. In the meantime, the latter was only invoked where dumping practice could be easily proved without the existence of urgent difficulties.

In the EU-China context, preference for anti-dumping has been further strengthened by the maintenance of the NME methodology. The WTO-minus commitment of China, in particular, the permission for the use of this discriminatory treatment, considerably increases the chance of duty imposition and releases the investigation burden on the part of the EU. Also, compared with the safeguard regime, the Basic Anti-dumping Regulation sets forth the more simplified and accessible rules for action enforcement, notably with regard to the complaint initiation of the private parties and the decision-making process of the political institutions.

In sum, the choice among different trade instruments primarily mirrors a trade-off between the costs and benefits of a particular instrument in the importing country concerned. Indeed, it is not a phenomenon existing only under the transitional mechanisms. The general WTO contingent system witnesses a similar logic. This observation nevertheless deviates from the expectation that these trade-restrictive measures should be first and foremost enforced in accordance with their fundamental rationales and envisaged targets stated in the multilateral agreements, i.e. the GATT, the ADA and the SGA. Indeed, such “instrument substitution” emerged in the

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[http://www.wto.org/english/res\\_e/booksp\\_e/anrep\\_e/world\\_trade\\_report09\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report09_e.pdf).

<sup>877</sup> Petros C. Mavroidis, Patrick A. Messerlin, Jasper M. Wauters, *The Law and Economics of Contingent Protection in the WTO*, Edward Elgar Publishing Ltd, 2008, p. 288.

national practice evidently goes against the WTO requirement for disciplined use of contingent trade protection.

The second observation focuses on the permissive national discretion under the transitional contingent systems, which, to a large extent, negates the influence of international commitments upon the domestic trade regime. It has already been argued that the WTO contingent protection constitutes an incomplete contract in terms of the regulatory integrity.<sup>878</sup> However, much more leeway in this regard has been preserved in the T&C sector, as well as under China's WTO membership.

In the case of T&C, policy developments at the multilateral level, i.e. the regime succession from the STA, the LTA, to the MFA and the ATC, had always been followed by the implementing adjustments in the EU legislation. However, most of the implementation did not reach the achievements as expected, which have been significantly distracted by the flexibility vested upon the national authorities. For instance, the MFA, while establishing a sector-specific safeguard system among the contracting parties, nevertheless accorded priority to the bilateral basket mechanism under EU's agreements with its T&C supplier countries. In the case of the ATC, the integration and acceleration programmes were heavily tainted by the back-loading policies implemented in the major importing Members. As a result, the EU managed to maintain the protectionist sectoral regime mainly untouched except a subtle movement toward market openness before the compulsory deadline arrived. Therefore, although the increasingly legalised transitional systems have been constantly used to advance the free trade agenda, the function of the corresponding domestic legal system does not always pursue the policy goal of trade liberalisation.

This discretion is further magnified under the WTO membership of China and the expectation for policy improvement in this regard ends up a great disappointment. The WTO-minus commitments included in the accession documents entitle the WTO Members to maintain most, if not all, of their controversial trade practice towards China, notably in the areas of anti-dumping and safeguards. In particular, the use of the NME approach and how to use this approach are fully subject to national decisions. For safeguards, the investigation authorities possess full command of the choice of safeguard mechanism in a particular case and Section 16 simply constitutes

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<sup>878</sup> Ibid.

an additional option where they consider measures under the SGA to be insufficient. Moreover, the textual brevity and vagueness of the accession documents make the above contingent mechanisms heavily dependent upon the national interpretation.

On the one hand, such permissive discretion might be a predictable outcome of the unbalanced negotiating powers and political compromise at the multilateral level; on the other hand, it cannot equal to national unconstraint in the policy-making process involving excessive indulgence of the domestic initiatives. However, what has emerges in the practice so far is that, while the mandatory effect of the multilateral disciplines appears minimal, domestic influence upon the policy formulation proves to be remarkable, even at the risk of violating the international obligations concerned.

During the 1992-1993 reform in the single market, the EU abolished the enduring practice of quota sub-division among its Member States and established the EU-wide T&C regime, which counted as the first substantial steps towards sector integration. Furthermore, the ATC achievement of the EU could be better explained by the structure and production transforms which emerged in the industries and the market, coupled with strong domestic demands for liberalised trade policies. Such success was in striking contrast with the MFA failure, when the domestic transforms mentioned above had not yet happened and the protectionist policy in this sector was highly requested domestically.

Outside the T&C sector, the grant of market economy status also primarily depends on the game playing within the EU. Without elaborate criteria specified in the legislation, the EU has to coordinate the divergent propositions from different Member States and pillar industries before reaching the recognition of such status. At the current stage, the maintenance of the NME methodology towards China indeed discloses the incapacity of the EU to mediate domestic disparities on this issue. One may also question the competence of China in the market economy test; however, the endorsement from most WTO Members and the fact that the EU has already granted the same status to Russia indicate, or to a certain extent necessitate, an understanding from another perspective.

Therefore, at the first sight, the relevant EU regimes have always been essentially

structured in line with the multilateral disciplines. On the other hand, a close study of the implementation process nevertheless indicates a compromise among different domestic interests. In other words, the EU, through manipulating the national prerogative, manages to control the market opening process at a rate tailored to the demands from various domestic groups. It does not necessarily mean that the GATT/WTO compatibility has been disregarded in the decision-making process; rather, the national autonomy granted under the transitional mechanisms renders the multilateral commitments hardly constitute any obstacle to the policy adjustments requested from inside of the EU. According to a well-known economic proposition, trade protection is more as a conflict between domestic export interests and import-competing interests than a conflict between countries.<sup>879</sup> In the EU, compared with the GATT/WTO commitments, the development needs of the domestic industries, the internal market and the Member States have played much more authoritative roles in the formulation of transitional trade policies.

The domestic discretion, which is categorised as interpretative flexibility, supplementary devices and autonomous initiatives, is indeed an indispensable element for the GATT/WTO enforcement. The involvement of the national powers is necessitated by first, the textual brevity in the relevant GATT/WTO agreements that cannot be effectively enforced without further elaboration from the national authorities; and second, the uniqueness and peculiarity of the political and economic structures of each Member. The transitional TDI systems of the EU, in both the T&C sector and the China-specific regime, establish adequate examples in this regard.

Nevertheless, flexible autonomous application is a double-edged sword. Despite the necessity analysis mentioned above, it might, due to the lack of multilateral control, hinder the target of smooth transition and result in unjustified protection on the sectoral or regional basis. For instance, the 2005 T&C crisis between the EU and China clearly demonstrated the incapacity of the industries and the market in the former, which could not be viewed as a satisfactory outcome after a series of reform programmes under the GATT/WTO. In the subsequent application of the Para 242 safeguards, the EU, to a certain extent, invoked the restrictions in response to the requests from other supplier countries. That this criterion was not mentioned in the Para 242 text nevertheless raises doubt about its WTO-compatibility. With regard to

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<sup>879</sup> Ibid, p. 289.

the NME methodology, discretionary enforcement is reflected in the non-publicity of the NME definition, random selection of the analogue country and flexible interpretation of the legislation. Such practice has received numerous criticisms from both the commentators and enterprises, some of which have been approved by the Court.

Furthermore, it also leads to adverse influence upon the systemic integrity of the WTO in that the Members are entitled to conduct diverse, or even conflicting, policies and standards in the same regulatory area. Challenges in this regard have already been raised at the WTO, which are primarily focused on the legitimacy of the autonomous policies in implementing China's accession documents.<sup>880</sup>

Therefore, following the "pro and con" discussion on the domestic discretion above, it is not difficult to conclude that such nation prerogative should be limited to the minimum extent possible. Instead of dominating the major policy formulation, it should not go beyond the role as only supplementary, or secondary, instruments in the domestic implementation process. Indeed, diminished policy flexibility is an indispensable element of the transitional mechanisms in terms of the targets to avoid excessive national protectionism, to effectively achieve the integration objective and to guarantee the regulatory integrity of the WTO system.

In the preceding chapters, proposals have been made concerning the improved and more disciplined use of discretion in the EU TDI practice. Indeed, it is of paramount importance for the EU to move in a more prudent direction. Apart from the temporary protection shelter for the import-competing industries, the investigation and the decision-making process should also involve sufficient consideration of the sectoral and regional development in the long term, as well as the interest of the domestic groups with marked exporting benefits. It does not necessarily mean that the EU has to significantly reduce its recourse to contingency instruments; instead, it aims at a more unbiased and cautious use of these instruments preventing contingent trade protection from mutating into an unjustified obstacle causing economic loss on both the exporting and importing sides.

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<sup>880</sup> *European Communities — Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China*, WT/DS397; *European Union — Anti-Dumping Measures on Certain Footwear from China*, WT/DS405.

For the future, the above observations raise the demand for increased multilateral control over the transitional contingent protection. Due to the conventional protectionist policy pre-occupying the areas under the transitional mechanisms, national regimes normally show considerable resistance to liberalised trading rules, which is in most cases combined with a frequent recourse to contingency instruments. Therefore, a competent WTO mechanism is expected to standardise and streamline the disciplined application of such trade restrictions and, in the meanwhile, spur adequate domestic preparation towards market opening. Unfortunately, none of the GATT/WTO mechanisms so far has qualified these criteria. As demonstrated in the T&C sector, the transitional mechanism does not necessarily lead to a “perfect world”. After the ATC integration, free trade in T&C is nevertheless frustrated by difficulties in the high level of tariff lines and the flood of behind-the-border NTBs. This experience suggests that, apart from the consistent and traditional emphasis upon contingent trade protection, a system designated for a smooth sectoral or regional integration should also embrace provisions with regard to the essential reform in domestic trade regimes. The integration and acceleration programmes under the ATC disclosed certain efforts in this direction, which were nevertheless proven to be insufficient in the subsequent practice. Indeed, depending on the peculiarity of the sector or region concerned, the sufficiency and competence test of a transitional mechanism, or the questions as to how and to what extent the national discretion should be reduced, can be investigated only on a case-by-case basis, which is thus open for future researches in particular areas. What emerges clearly from this thesis is, insofar as the application of transitional contingency instruments are concerned, that there are imperative requirements for more elaborate guidelines and substantialised control from the multilateral forum, which should first and foremost be espoused by the delineated and decreased unilateral manoeuvre in the domestic implementation process.

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