WTO Compatibility with EU Action on Deforestation

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Acknowledgements

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The EU has set itself the goal of ending deforestation by 2030. More than 70 per cent of deforestation in the tropics is the result of land being cleared for commercial agriculture. 36 per cent of the crops and livestock products that were grown on deforested land and traded internationally, was consumed by the EU: twice as much as China and Japan combined. Even in 2015, with China’s consumption increasing at a rapid rate, the EU still has a far larger footprint per person than China.

Much of this deforestation is illegal. In 2012 alone the EU imported EUR six billion of soy, beef, leather and oil palm that came from land illegally cleared of forests. Not only is our consumption destroying forests: it is undermining global governance and the rule of law.

Market pressure from consumers who do not want to be party to this trail of destruction is increasing. Far-reaching corporate commitments on zero deforestation have shown that businesses are also ready to act. But consumers and companies cannot act alone.

The EU, as one of the largest importers of forest risk commodities needs to act and serve as a model for others. It must base its policies on the fact that many of the world’s forests belong to communities who depend on them. Forest protection will not work, therefore, unless it goes hand in hand with respecting and strengthening communities’ tenure rights.

This report is one of a series presenting recommendations to the EU for an Action Plan to halt deforestation and respect rights, looking at EU aid, climate, consumption, financial, illegal logging, renewable energy and trade policies. Together, the series forms a comprehensive action plan for the EU, available at www.fern.org/EUdrivers.

“I do not want a Europe stuck on the sidelines of history … I want a Europe at the heart of the action, a Europe which moves forward, a Europe which exists, protects, wins and serves as a model for others.”

Jean-Claude Juncker, President of the European Commission, Opening Statement in European Parliament, 15 July 2014
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Acronyms

CITES Convention on International Trade in Endangered Species of Wild Fauna and Flora
GATT General Agreement on Tariffs and Trade
GPA Government Procurement Agreement
MEA multilateral environmental agreement
PPMs processes and production methods
RSPO Round Table on Sustainable Palm Oil
WTO World Trade Organisation
Summary

A number of policy recommendations outlined in Fern’s report *Protecting Forests, Respecting Rights: Options for EU Action on Deforestation and Forest Degradation* involve making distinctions, for the purposes of trade, between agricultural products that have been produced sustainably and those that have not: i.e. giving trade preferences to sustainable products.

This report shows that, if done correctly, this is entirely possible under World Trade Organisation (WTO) rules as they do not preclude a government from putting in place policies or regulations that regulate trade on the basis of sustainability. If well formulated, government policies and laws restricting imports can be WTO-compatible.

1. [www.fern.org/protectingforests](http://www.fern.org/protectingforests)
Introduction

One of the ultimate aims of Fern’s work towards an EU Action Plan on Deforestation is to achieve a system which only permits sustainable products to enter international trade in the first place. The kind of measures needed to achieve this aim, however, must fit within the constraints of WTO rules.

The possible interaction of environmental and trade policies, and the legal and economic implications, have been much debated over the last two decades or so, in particular since the creation of the WTO in 1995. The relatively small number of WTO dispute cases which have involved policies aimed overtly at protecting the environment have been pored over extensively – though without generating any real consensus about a way forward.

The mere fact of raising the question of WTO implications can have a chilling effect on the debate over regulations affecting trade. Since relatively few people really understand how the WTO system works, and since it is not clear how the WTO relates to many new environmental policies, policy-makers can end up with the impression that any policy affecting international trade must be in conflict with WTO rules. Indeed, critics of various proposed measures have sometimes claimed this in support of their arguments.

In reality, however, the control of international trade can often form a vital part of environmental policies, and various trade-related environmental measures have had a good record of success in achieving their environmental goals while causing minimal disruption to trade. Several multilateral environmental agreements (MEAs), including the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES), the Montreal Protocol on the Depletion of the Ozone Layer, and several regional fisheries conventions, incorporate restrictions on trade to encourage adherence to, and enforce compliance with, their provisions. None have led to any WTO disputes.

In recent years, international efforts to control illegal logging have seen several policy measures adopted explicitly to exclude illegal (and sometimes unsustainable) timber from consumer-country markets, including licensing systems aimed at only permitting trade in timber which has been licensed as legally produced; ‘due diligence’ systems placing requirements on companies to scrutinise their own supply chains; prohibitions on timber produced illegally overseas being placed on the home market; and the use of public procurement policy to specify only legal and sustainable timber. Once again, none of these measures have led to any WTO disputes. It is possible that many of them could be adapted to apply to the trade in sustainable agricultural products.

WTO rules do place boundaries, however, on the measures that governments can adopt. This report gives a brief summary of the WTO system and its potential interface with measures designed to control the trade in unsustainable agricultural products.

“Our ultimate aim is a system which permits only sustainable products to enter international trade in the first place... the measures needed to do this must fit within the constraints of World Trade Organisation rules.”
Protest activity surrounding the WTO Ministerial Conference of 1999. The WTO has been criticised for widening the social gap between rich and poor it claims to be fixing. Critics claim that developing countries have not benefited from the WTO Agreements and that therefore, the credibility of the WTO trade system has been eroded.
How the WTO system works

WTO member countries – of which there were 160 as of February 2015 – enjoy the privileges that other members give to them and the security that the trading rules provide. In return, they must make commitments to open their markets and to abide by WTO rules. The WTO agreements lay down general rules for governments to follow in liberalising international trade. They cannot possibly deal with every specific traded product or service, so they set out broad principles which must be interpreted and applied in particular dispute cases where one WTO member believes that another is failing to comply with them. (It is worth noting that WTO rules apply only to governments and public policy, not to private enterprises.)

The WTO system is based around opposition to discrimination in trade. Its core principles are to be found in the following articles of its core agreement, the General Agreement on Tariffs and Trade (GATT):

— GATT Articles I (‘most favoured nation’ treatment) and III (‘national treatment’) outlaw discrimination: WTO members are not permitted to discriminate between traded ‘like products’ produced by other WTO members, or between domestic and international ‘like products’.

— GATT Article XI (‘elimination of quantitative restrictions’) forbids any restrictions other than duties, taxes or other charges on imports from and exports to other WTO members.

One of the main criticisms of the WTO has been that rich countries are able to maintain high import duties and quotas in certain products, blocking imports from developing countries.
Essentially the same principles are built into all the other WTO agreements that have developed alongside the GATT. It was always recognised, however, that some circumstances justified exceptions to this general approach, permitting governments to make unilateral trade restrictions in particular circumstances. These exceptions are set out in GATT Article XX, and include:

- measures ‘necessary to protect human, animal or plant life or health’ (Article XX(b))
- measures ‘relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption’ (Article XX(g)).

These two exceptions have been cited in a series of dispute cases concerned with trade measures taken with the aim of protecting the environment. The key question is whether the disruption to trade in each case can be justified under these wordings.

For instance, in the case of Article XX(b), is the trade-restrictive measure really necessary to the environmental objective, or are there alternative measures available that could achieve the same ends with less disruption to trade? In each of these cases, however, the headnote to Article XX makes it clear that even where these conditions apply, WTO members are not allowed to discriminate in arbitrary or unjustifiable ways between countries where the same conditions prevail – an expression of the core WTO principle.

“Since there has never been a dispute case involving trade measures taken to give preference to sustainable agricultural products, or to keep unsustainable ones out of particular markets, it is not known exactly how a dispute panel would rule. All that can be done is to extrapolate from other disputes.”
of non-discrimination between products from different countries and between domestic products and imports.

Dispute cases revolve around the interpretation of these WTO rules. The bodies that carry out these interpretations are the dispute panels (generally composed of trade experts) which issue an initial set of findings, and the WTO Appellate Body (mostly international lawyers), to which dissatisfied parties can appeal. Since their decisions can only be overturned if all WTO members (other than those involved in the dispute) agree – which has never happened – this system is a powerful means of resolving conflicts and ensuring that trade rules are interpreted and applied consistently around the world. If the loser in any given case does not modify its policy accordingly, the winner is entitled to take trade-restrictive measures (e.g. to apply tariffs) against the loser, to the estimated value of the trade lost because of the loser’s action.

It should be noted that interpretations can change, even if the wording that is being interpreted does not. Over the period since the founding of the WTO in 1995, decisions by the Appellate Body in particular have helped to shift the way in which the WTO system is applied, especially in environment-related disputes. It is this key role of interpretation that often leads to uncertainty and disagreement over what the WTO rules might mean in practice. Since there has never been a dispute case involving trade measures taken to give preference to sustainable agricultural products, or to keep unsustainable ones out of particular markets, it is not known exactly how a dispute panel, or the Appellate Body, would rule. All that can be done is to extrapolate from other disputes.

"Several multilateral environmental agreements incorporate restrictions on trade to encourage adherence to, and enforce compliance with, their provisions. None have led to any WTO disputes."

Harbour, Rotterdam, The Netherlands. © F.Berkelaar/FlickrCC
Using trade measures to promote sustainable agricultural products

Other Fern reports explore in more detail a series of options to promote sustainable agricultural products in international trade, or to exclude unsustainable agricultural products from consumer markets – such as lower import duties for sustainable products, or agreements between importing and exporting countries designed to limit trade in sustainable products. In each case, the following questions need to be addressed in connection with the WTO implications of the measures.

“A number of WTO disputes have comprehensively undermined the conclusion that discrimination is not permitted on the basis of their processes and production methods.”

Can sustainable and unsustainable products be deemed to be ‘like products’?

Many of the measures that Fern proposes depend on discriminating between agricultural products on the basis of their means of production – or, in WTO jargon, their processes and production methods (PPMs) – which define ‘sustainability’ for the purposes of the policy. As noted above, WTO rules forbid discrimination between ‘like products’. The question of whether products possessing identical physical characteristics but grown, harvested or processed in different ways are ‘like products’ was extensively discussed in the early years of the trade–environment debate, particularly after a GATT panel ruling (in the tuna–dolphin case in 1991) suggested that this kind of discrimination was not compatible with the GATT: a conclusion which became conventional wisdom and which, in some quarters, is still regarded as such.

In fact, however, no such language exists in the GATT or other WTO agreements, and a number of later WTO disputes (in particular in the shrimp–turtle disputes of 1998 and 2001 and the asbestos case of 2001) comprehensively undermined the conclusion that discrimination is not permitted on the basis of PPMs. The final outcome of the shrimp–turtle dispute, for example, saw the US being permitted to maintain its embargo on imports of shrimp caught in ways which killed endangered species of sea turtles – a PPM. This long-running dispute, involving two separate cases, led to a number of conclusions with important implications for PPM-based trade discrimination, including:

— ‘Exhaustible natural resources’ (as termed in GATT Article XX(g)) are not limited to finite resources such as minerals, but can include living species that are susceptible to depletion.

— A measure may target resources outside the country which applies the trade restrictions, where there is a ‘nexus’ between the resource and that country.

— The restrictive measure adopted must be related to (i.e. be primarily aimed at) the objective of preserving the resources. (The original form of the US embargo prohibited all shrimp imports from countries which did not require the fitting of turtle-excluder devices to their fishing fleet’s trawl nets – even if an individual shipment had been caught in turtle-friendly ways. After the dispute ruling, the US modified its policy to apply it on a shipment-by-shipment basis.)

— The measure must be enforced evenly between domestic and foreign products and between different foreign countries.

— The country seeking to regulate should negotiate in good faith with other countries with a view to seeking multilateral agreement. In the later case, however, the Appellate Body clarified that unilateral environmental measures which restrict trade may still be lawful even in the absence of bilateral or multilateral agreements. (In the second stage of the shrimp–turtle dispute, the US had tried, but failed, to negotiate an agreement with the complainants.)
The success of Greenpeace’s campaign in 2010 against Nestlé’s use of palm oil in the manufacture of Kit Kat bars suggests that consumers are able to distinguish products made with palm oil.

Bearing these constraints in mind, it would appear that WTO rules do permit countries to treat products differently in trade on the basis of the way in which they were produced – which could include measures of ‘sustainability’.

Could other sustainably produced products also be considered to be ‘like products’?

The definition of ‘like product’ is still important in determining what exactly the product is, even if it is produced sustainably. Of the commodities most strongly associated with deforestation, this question is most relevant to palm oil, which could be considered to be a ‘like product’ with other vegetable oils, such as soya, corn, rapeseed and sunflower oil.

The outcome of the 2001 asbestos WTO dispute case helped to clarify the definition of ‘like product’. Four criteria were considered to be relevant:

— the physical properties of the products
— the extent to which the products are capable of serving the same or similar end uses
— 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
— the international classification of the products for tariff purposes.

This was a significant expansion beyond the simple notion that only physical differences present in the product itself counted in the analysis. Essentially, the determination of ‘likeness’ is a determination about the nature and extent of the competitive relationships between and among products.

In some ways vegetable oils are highly substitutable for each other (unsurprisingly, as most oilseeds contain the same fatty acids, though in different combinations), being equally usable, for example, as a base for frying, a food additive or a component of biodiesel. In other ways, however, they are different: palm oil tends to be much more energy-dense than other vegetable oils (one reason why it is such a successful crop), and it grows in different conditions and, usually, different countries. Vegetable oils also possess different tariff classifications under the Harmonised System of customs codes; and in the EU, since December 2014, it must be identified individually on food labels (rather than being covered by the generic term ‘vegetable oil’).

The success of Greenpeace’s campaign in 2010 against Nestlé’s use of palm oil in the manufacture of Kit Kat bars, and its accompanying impact on orang-utan habitats, suggests that consumers are able to distinguish products made with palm oil – i.e. that the oils are not ‘like’ – but also that they would be happy to accept products made with other vegetable oils – i.e. that they are ‘like’.

This matters because if any trade measure is used to give preference to sustainable palm oil, if palm oil and other vegetable oils are considered to be ‘like’, then a similar preference would have to be given to sustainable vegetable oils in general. Of course this may itself be a desirable outcome, though it would at the very least complicate the measure. It also may not have to be exactly the same preference: the EU’s sustainability criteria for biofuels, for example, cover several different oils, but treat them differently in terms of default values for greenhouse gas.

For more information, see ‘Protecting Forests ‘Burning Matter: Making EU Climate and Bioenergy Policy Work for People and Forests’ www.fern.org/burningmatter.
emission savings (see Fern’s report ➤ *Burning Matter: Making EU Climate and Bioenergy Policy Work for People and Forests*). The question of ‘likeness’ is a difficult one to judge, and it would have to be determined in relation to the trade measure in question if it came to a WTO dispute.

**What is ‘sustainable’?**

How can ‘sustainable’ agricultural products be defined? In general, WTO agreements – including the Technical Barriers to Trade Agreement and the Government Procurement Agreement (see below) – require criteria to be expressed in terms of performance rather than design or descriptive characteristics. So trade preferences given to ‘sustainable palm oil’, for example, might be permissible, but specifying ‘sustainable palm oil’ as only those products certified by the Round Table on Sustainable Palm Oil (RSPO) would not be. The government applying the measure would have to draw up a list of criteria (which, in this example, could be equivalent to, or even exactly the same as, those of the RSPO standard) which any supplier could potentially meet, regardless of its membership of RSPO. It would also have to devise a means of judging whether the products satisfied the criteria without the process imposing undue costs on the companies exporting or importing the product. There is no reason to think that this could not be done; the same challenges have been faced, successfully, in implementing public procurement policies for timber: see Fern’s report ➤ *The Power of Public Purchasing: Making EU Public Procurement Policy Work for People and Forests*.
Government procurement

Public procurement was explicitly excluded from the GATT when it was first negotiated, largely because of its widespread use as a means of supporting national suppliers and as an element of industrial policy. Although government procurement measures are now subject to the WTO Government Procurement Agreement (GPA), this is significantly different from the GATT and other WTO agreements. It is a plurilateral agreement, to which not all WTO members are parties; in fact, as at January 2015, only the EU (and all its Member States) and 14 other countries are parties.

This includes the US, but no other major exporter of forest-risk commodities. In addition, GPA rules do not apply automatically to all procurement contracts; GPA parties specify the government entities and services they decide to have covered, and also minimum threshold values, and they can also specify exclusions. So agricultural products do not necessarily have to be covered, and they could be subject to exemptions even if they are.

For EU Member States, EU procurement rules are much more relevant than WTO procurement rules. See Fern’s report ➤ *The Power of Public Purchasing: Making EU Public Procurement Policy Work for People and Forests*.


www.fern.org/publicpurchasing
Conclusion

The following conclusions can therefore be drawn for the WTO treatment of trade measures designed to discriminate between sustainable and unsustainable agricultural products:

— Multilateral or bilateral measures are preferable to unilateral ones. (Where the measure is agreed between states, they would hardly challenge it under the WTO in any case.)

— The more the trade measure diverges from the core WTO principle of non-discrimination in trade, the more vulnerable it could be to challenge. So where trade measures are imposed without agreement, domestic products must be treated in the same way as imports.

— ‘Sustainability’ needs to be defined in a non-discriminatory way, i.e. by criteria rather than by membership of a particular certification scheme.

— There is a question mark over the ‘likeness’ of palm oil and other vegetable oils. It may be that any preferences given to sustainable palm oil may also have to be afforded to other vegetable oils produced sustainably (though the preferences may not need to be identical).

Despite this, concerns remain over the possible use of PPM-based trade measures. Developing countries in particular often see them as a potential form of protectionism, because of developed countries imposing their environmental standards (assumed to be higher and more costly) on poorer countries’ exports. Accordingly, the ongoing discussions within the WTO about the potential for eliminating tariff and non-tariff barriers to environmental goods and services – an element of the trade negotiations launched in Doha in 2001 – have tended to shy away from considering ‘environmentally preferable products’, such as sustainable agricultural products, because of their perceived uncertain status under the WTO agreements. A listing of proposed environmental goods discussed by the WTO’s Committee on Trade and Environment in 2010, for example, does not contain any goods distinguished by virtue of their PPMs. There have been several proposals outside the WTO for environmentally preferable products based on PPMs, such as sustainable agricultural products, to be included in lists of environmental goods which should be afforded preferences, but none of these proposals have made any headway.

In reality, however, these debates in the WTO have fallen behind the spread of environmental (and social) standards, covering, for example, sustainable timber and fish, organic food and textiles, fair-trade products and many others. Increasingly common in international trade, these standards may often be applied by the private sector rather than by governments, with the aims of satisfying consumer markets, building brand reputation and helping to secure supply chains. In general, developing countries – particularly the poorer ones – possess less capacity to adapt to standards and regulations such as these, which are usually drawn up by developed-country enterprises and agencies. Thus, in reality, the need for capacity-building initiatives and the construction of decision-making structures that reflect all interests fairly may be more important issues for debate than the WTO status of PPM-related trade measures. Trade measures designed to exclude unsustainable products should, therefore, be accompanied as much as possible by capacity-building assistance, for example in expanding certification schemes, for poorer countries.

“Debates in the WTO have fallen behind the spread of environmental and social standards, covering sustainable timber and fish, organic food and textiles, fair-trade products and many others.”
“WTO rules do not preclude a government from putting in place policies or regulations that regulate trade on the basis of sustainability. If well formulated, government policies and laws restricting imports can be WTO-compatible.”