CENTER FOR INTERNATIONAL ENVIRONMENTAL LAW

SECOND GUESSING NATIONAL LEVEL POLICY CHOICES: NECESSITY, PROPORTIONALITY AND BALANCE IN THE WTO SERVICES NEGOTIATIONS

EXECUTIVE SUMMARY

In the current World Trade Organization (WTO) negotiations to liberalize trade in services, the European Communities (EC) proposes a "proportionality test" for measures relating to technical regulations, licensing and qualification requirements. In the same negotiations, Japan has recently proposed a Draft Annex on Domestic Regulation, which contains several differently formulated "necessity tests", but nevertheless stops short of including a specific proportionality test.

Proportionality and balancing analyses are well-established concepts in European law. The WTO legal framework already includes several necessity tests (which have been the subject of judicial and academic scrutiny) but to date WTO law does not contain an explicit proportionality or balancing test. Understanding about the potential meaning and consequences of introducing these terms into the General Agreement on Trade in Services (GATS) is currently limited.

This paper aims to assist policy makers, both at the national and international levels, in making informed choices about whether to follow the EC proposal or the Japanese Draft for possible future GATS disciplines on domestic regulation (Article VI.4 GATS).[1] Negotiations on this issue will almost certainly continue, with the upcoming 5th Ministerial Conference in Cancun likely to add momentum. Affected stakeholders therefore need to consider in advance possible implications.

After providing background, the paper explains the general meaning of the concepts "necessity", "proportionality" and "balancing" in WTO law and in other relevant regional legal frameworks. The paper then outlines the EC proposal, which suggests that WTO Members, when developing future disciplines on domestic services regulation, complement the current Article VI.4 necessity test with an explicit proportionality test. The paper also reviews the Japanese Draft and the various necessity tests contained therein.

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Incorporating an explicit proportionality test into the WTO legal framework would have significant, far-reaching implications for the interaction between WTO law and the sovereignty of its Member governments. Adopting such a test would inappropriately expand the domain of the WTO while undermining domestic authority. More specifically, in the case of a dispute, it would allow WTO panels and the Appellate Body (AB) to outlaw domestic measures whose trade restrictive effects they consider "disproportionate" to or "out of balance" with the legitimate objectives these domestic measures aim to achieve. Whether WTO tribunals at the international level should even be vested with the authority to balance economic against non-economic factors within national sovereignties remains a question. Such fundamental balancing choices have, for good reasons, traditionally been the prerogative of domestic legislators and adjudicators.

The paper concludes that, before agreeing on international, legally binding obligations, trade policy makers and national regulators need to thoroughly and comprehensively assess and debate the potential effects that new necessity or proportionality tests in future rules on services would have on domestic regulatory prerogatives.

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1. BACKGROUND

The Preamble of the Marrakesh Agreement Establishing the WTO[2] sets out organizational objectives, including:

- raising the standards of living;
- ensuring full employment;
- allowing for the optimal use of the world's resources in accordance with the objective of sustainable development;
- expanding the production of and trade in goods and services;
- ensuring a share in growth in international trade for developing countries;
- reducing tariffs and other barriers to trade; and
- eliminating discriminatory treatment.

These objectives include a broad set of policy goals, ranging from economic to the less quantifiable. At face value, some of these objectives seem incompatible; achieving one goal could require sacrificing resources from the pursuit of another.

WTO agreements include provisions that might - to a limited degree - allow for a balancing of these objectives. Qualifiers such as "appropriate", "necessary" and "reasonable" signal an attempt to weigh certain objectives against one another. Other legal systems, such as those in the EU or the US, more specifically use criteria referred to as "proportionality" or "cost-benefit analysis",[3] allowing for a more extensive weighing and balancing of conflicting policy objectives.

The meaning of these terms is not always straight-forward, yet, when applied in specific contexts, it is clearly important, as it determines what national regulators may and may not do. Some interpretations may over-privilege trade promotion at the expense of other objectives, such as protecting the environment and human health. This has already given rise to claims that the WTO has ignored development and has acted in an "anti-green, anti-health and undemocratic" manner.

Just as important as *where* the balance in each case is determined to lie is *who* makes the decision. Traditionally, balancing two potentially conflicting policy objectives has been the purview of domestic democratic institutions, such as elected councils and parliaments. In theory, the WTO framework defers to such national decision-making bodies: the majority of WTO decisions are taken by consensus among all WTO Members.

This is particularly important with respect to the WTO's rule-making work, i.e. the creation of new international rules and obligations that will ultimately set the limits for domestic regulatory actions. Decisions on whether or not to negotiate a particular issue and the content of new rules and disciplines are taken unanimously, at least in theory.[4]

However, the situation is different in the context of the WTO's dispute settlement function. Disputes over whether a Member's trade measure breaches a WTO agreement can be brought before WTO panels or the AB, which are comprised of various Member States. Ultimately, the WTO Dispute Settlement Body (DSB), which includes all Members, has domain over rulings by these bodies. However, the appearance of "democracy" implied by the inclusivity of the DSB is misleading: unlike the WTO's law-making functions, the DSB operates under a reversed consensus rule. Under *reversed* consensus, the DSB adopts a panel or AB report unless *each and every* WTO Member objects to it. This means that if a panel or AB report rules that a Member's domestic measure is in violation of WTO obligations, the violating Member must conform to the ruling *unless all* Members of the DSB disagree with that conclusion.[5]

This framework effectively wrests the authority to determine and adjudicate domestic policy away from national governments. Assuming that a panel or the AB, in applying a necessity or proportionality test, would have the leeway to analyze whether a domestic measure is "disproportionate" to or "out of balance" with its objective, the WTO would effectively co-opt the role of evaluating national policies. The charge of weighing and evaluating policy objectives would no longer belong to national authorities but to the WTO.

Current developments suggest that WTO decision making could usurp national authority in just such a way. First, some recent AB reports interpret existing necessity tests to include certain balancing elements, which are among the defining characteristics of a proportionality test. Second, current negotiations on trade in services have discussed the inclusion of a proportionality test in new WTO disciplines. Explicitly including such a weighing mechanism in new services rules would broaden the WTO's latitude for judging the value of Members' national policy goals - judgments traditionally reserved for domestic authorities.

2. ANALYSIS OF NECESSITY AND PROPORTIONALITY

2.1. NECESSITY - A TRADE / WTO LAW CONCEPT

The concept of "necessity" implies that no alternative exists to achieve a certain end. Something that is "necessary" is a prerequisite, obligatory or essential. A "necessity", in principle, is something that cannot be balanced or proportioned against anything else.[6]

However, a standard law dictionary cautions that "[t]his word must be considered in the connection in which it is used, as it is a word susceptible of various meanings. It may import absolute physical necessity or inevitability, or it may import that which is only convenient, useful, appropriate, suitable, proper, or conducive to the end sought. It is an adjective expressing degrees, and may express mere convenience or that which is indispensable or an absolute physical necessity."[7]

WTO agreements contain several necessity tests,[8] most of which have not yet been applied and interpreted in dispute settlement cases. Notable exceptions are the necessity tests contained in Article XX of the General Agreement on Tariffs and Trade (GATT). In this context, GATT and WTO jurisprudence have provided different interpretations and applications of "necessity".[9]

The first case to interpret "necessity" was the GATT panel in US - *Section 337 of the Tariff Act of 1930*. According to the panel, "necessary", in the context of Article XX(d) GATT, means that no alternative measure exists which the country "could reasonably be expected to employ" and "which is not inconsistent with other GATT provisions" or "which entails the least degree of inconsistency with other GATT provisions."[10]

This interpretation was followed by the panels in *Thailand - Cigarettes*[11] and *US - Reformulated Gasoline*,[12] in relation to the necessity test of Article XX (b) GATT.

Some consider such an interpretation to impinge too heavily upon Members' regulatory autonomy to pursue legitimate, non-economic objectives.[13] The fear is that these tests could constrain domestic policy choices, if GATT panels were to conclude that costly alternatives or alternatives that would exhibit negative side effects, were "reasonably available".

Without going so far as to *evaluate the objective* of a measure deemed necessary by a Member State, this interpretation of the necessity test only evaluates "necessity" on the basis of whether a reasonable alternative is available; a "necessary" measure, under this interpretation, is one without a reasonable alternative. Significantly, panels in these cases do not balance or weigh legitimate objectives against each other; nor do they determine whether the national policy in question should be regarded as necessary or important (thus leaving that decision to national authorities themselves).

However, two more recent WTO cases, considered below, take up just such a task. In applying necessity tests, these cases develop evaluation parameters, including the weighing and balancing of domestic policy objectives against the measure's trade restrictive impact.

In *Korea - Beef*,[14] the AB states that "the word 'necessary' refers … to a range of degrees of necessity. At one end of this continuum lies 'necessary' understood as 'indispensable'; at the other end is 'necessity' taken to mean as 'making a contribution to …'"[15] The AB remarks that "in the context of Article XX (d), the reach of the word 'necessary' is not limited to that which is 'indispensable' or 'of absolute necessity' or 'inevitable.'"[16] The AB further reasons that "[t]he determination of whether a measure, which is *not 'indispensable', may nevertheless be 'necessary'*… involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the … measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected ... and the accompanying impact of the law or regulation on imports or exports" (emphasis added).[17] By asserting that a determination of necessity should include a "weighing" and "balancing" of a "series of factors", including the importance of the domestic policy goal, the AB effectively extended WTO jurisdiction to judgments formerly reserved for national governments.

In *EC - Asbestos*,[18] the AB builds upon this approach by further clarifying which factors can or cannot be evaluated against each other. Specifically, it transfers the weighing and balancing approach used for Article XX (d) GATT to Article XX (b) GATT.[19] In the latter case, the AB makes clear that "weighing and balancing" must *not* balance the *level of protection* that a measure affords against the resulting amount of trade restriction. Thus, the AB suggests that the WTO can only require a Member to substitute a regulatory measure for an alternative which is determined to be *at least as protective* but *less* trade restrictive. According to the AB, a Member *cannot* be required to substitute a measure for an alternative that is *less* protective simply because it is also less trade restrictive. Importantly, this interpretation of necessity only applies to measures that are not "indispensable" for the attainment of a legitimate goal and for the particular level of protection. A future proportionality test could extend the balancing even further to apply to indispensable measures.

Article XX of the GATT - Relevant Excerpts

"Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:

(a) necessary to protect public morals;

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

(d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement…"

Consequently, the *EC - Asbestos* ruling seems to protect national authority to determine and preserve policies at least to some degree. However, some of the language used in the decision also gives rise to concerns. The *EC - Asbestos* ruling has the potential to erode national authority by permitting the WTO to consider the value and importance of the policy goal that a measure aims to achieve. Following suit with earlier cases, the AB confirms in *EC - Asbestos* that the importance of the objective that the measure aims to achieve is a determining factor in the ultimate decision on the WTO consistency of the measure. Specifically, it reiterates its statement in *Korea - Beef*, that "[t]he more vital or important [the] common interests or values" pursued, the easier it would be to accept as "necessary" measures designed to achieve those ends.[20]

The result is that the importance of the objective can determine the legality of a measure. Under this interpretation, the necessity test begins, in fact, to take on elements of a "proportionality test", in that pursued ends are weighed against their trade-restrictive effects.[21] Potential scenarios raise even greater concern; for example, if a WTO Member were to implement a domestic measure in the pursuit of a policy objective that was not explicitly recognized by the relevant WTO necessity test provision,[22] then WTO tribunals would not just engage in determining the importance and legitimacy of the policy goal, but rather could decide that the policy goal is not legitimate at all.[23] This scenario would clearly expand the prerogative of WTO tribunals at the expense of domestic decision-making power.

However, WTO tribunals need not always take such a stringent approach in each and every instance. Future WTO tribunals could decide to apply a more deferential interpretation of necessity, depending on the context. There is not a single reading of "necessity", and different necessity tests in the various WTO Agreements could require different interpretations. [24]

The Meaning of the "Necessity Test"- a WTO Secretariat Perspective

"The necessity test - especially the requirement that regulatory measures be no more trade restrictive than necessary - is the means by which an effort is made to balance between two potentially conflicting priorities: promoting trade expansion versus protecting the regulatory rights of governments."

Source: WTO, unpublished note by the Secretariat, Working Party on Domestic Regulation, *Application of the Necessity Test: Issues for Consideration*, Job No. 5929 (19 Mar. 2000).

At the same time, for the sake of consistency, tribunals and Members could seek and apply a universal interpretation. Such an interpretation would not necessarily defer to national authority. At the request of the GATS Working Party on Domestic Regulation (WPDR), the WTO Secretariat prepared a note on how to interpret necessity tests in the WTO agreements.[25] Although not legally binding, the Secretariat's definition does carry some political weight.

In this definition, the Secretariat goes even further than current WTO jurisprudence in expanding the organization's ability to weigh and balance national policies: it explicitly recognizes the WTO's prerogative to balance conflicting policy objectives. In doing so, the Secretariat's understanding seems to depart from the generally accepted meaning of the word "necessary". Such a non-deferential interpretation could be applied to tests that arise in other WTO agreements and in other contexts. As regards WTO agreements, the most relevant provisions are contained in GATS, GATT, the Agreement on Technical Barriers to Trade (TBT), and the Agreement on Sanitary and Phytosanitary Measures (SPS).[26]

Thus, the various interpretations of a necessity test determine the extent to which it constrains domestic regulatory prerogatives. In addition, the specific wording - for example, whether the test is categorized as an exception or as a rule - determines the degree to which it defers to national sovereignty.

If formulated as an exception, a necessity test could potentially have the effect of increasing domestic regulatory prerogatives. In this case, the necessity of a measure is only questioned if that measure is considered to be in violation of WTO rules - it only applies once a measure has been successfully challenged in the WTO. If the violating measure meets the criteria set out under the necessity test, it is then "saved" by the test. For such measures, the necessity test opens an avenue for justifying their preservation. Necessity tests contained in Article XIV of GATS and Article XX of GATT are similar in nature and construed as exceptions. Members can invoke the exception clause in Article XIV to save an otherwise GATS-inconsistent domestic policy measure, if it is *necessary* to protect major public interests, including safety, human, plant or animal life or health, national security or public morals.

The situation is different in the case where a necessity test is classified as a part of positive rule rather than an exception. In that case, the test provides that a State *must* adopt policies that are no more trade restrictive than necessary, regardless of whether the measure in question has been determined to violate a WTO obligation. Here, the necessity test poses additional constraints upon domestic regulatory prerogatives because it applies to measures even before any WTO inconsistency has been established and to measure found to be otherwise WTO consistent. Both Article VI.4 and Article VI.5 of GATS contain necessity tests which are contained as rules. Specifically, Article VI.4 requires WTO Members to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute *unnecessary* barriers to trade in services.

Likewise, Article 2.2 of TBT contains a necessity test for technical regulations and standards that constitutes a rule: "Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating *unnecessary* obstacles to trade. For this purpose, technical regulations shall not be more trade restrictive than *necessary*".

Lastly, Articles 2.2 and 5.6 of SPS contain necessity tests regarding health measures, also formulated as rules: "Members shall ensure that any sanitary and phytosanitary measure is applied only to the extent *necessary* to protect human, animal or plant life or health".

Given the broad impact that rules-type necessity tests may have on domestic regulatory prerogatives, the question of whether the necessity test is interpreted to include proportioning elements or whether it is entirely changed to a proportionality test is of even greater importance.

2.2. PROPORTIONALITY: A EUROPEAN LAW CONCEPT

Proportionality is a general principle of EC law. Apart from placing limitations on community action,[27] the EC proportionality principle also places limitations on national measures that restrict trade in goods and services between European Member States. Any trade restriction has to be "proportionate" to the value it aims to achieve. When interpreting the EC Treaty provisions relevant to trade in goods and services, the European Court of Justice (ECJ) has developed a proportionality test consisting of three steps: effectiveness, necessity and proportionality *strictu sensu*:[28]

1. A national measure has to be *effective*. That means that it has to be *capable* of fostering the real ization of the legitimate policy goal.
2. A national measure has to be *necessary* to achieve the legitimate objective in question. Necessity implies that there is no other alternative measure available that would reach the legitimate goal just as effectively, but in a less trade-restricting way.
3. Restrictions of trade in goods or services between Members also have to be *proportionate strictu sensu*. In that context, a restriction on free trade must not be out of proportion to the benefits arising from the pro tection of the legitimate value, which the measure aims to pursue.

This analysis requires - in its third step - that non-economic values be weighed against the costs of the trade restriction.

An EC "Proportionality Test" Case Study

The Danish Nitrates Regulation - Limits of EC Harmonization

In March 2003, the European Court of Justice (ECJ) annulled the Commission's decision refusing authorization for Danish regulations on the use of nitrates and nitrites as food additives. Essentially, the Commission had prohibited these Danish rules because they are stricter than the respective harmonized EC provisions.

According to the Court in case C-3/00, a Member State may maintain existing national provisions and may derogate from a harmonization measure when it considers that the risk to public health is greater than that found by the EC legislature at the time the harmonization measure was adopted. In light of the uncertainty inherent in the assessment of public health risks, divergent assessments can legitimately be made, without necessarily being based on new or different scientific evidence. The Member State must only prove that the derogating national provisions ensure a level of health protection which is higher than that pursued by the EC harmonization measure and that the national provisions do not go beyond what is necessary to attain that objective. Interestingly, the ECJ did not discuss whether the Danish provision was proportionate in the strict sense.

The EC Treaty contains a closed list of legitimate objectives that can justify trade restrictions. Nonetheless, in its jurisdprudence the ECJ has recognized additional policy objectives, including environmental protection, which are not explicitly listed in the legal provision.[29] A finding that a measure is disproportionate means that the Member must reduce the level of protection it gives to its pursued interest. This significantly interferes with a Member's domestic regulatory choices. Therefore, the ECJ has, for the most part, been careful when balancing different values and has only outlawed extreme cases of imbalance. More often, the Court has left the final decision concerning proportionality to national courts.

The Swedish Alcohol Advertising Ban

In 2001, the European Court of Justice (ECJ) held that the *Swedish Alcohol Advertising Ban* constitutes an obstacle to trade of goods and services between Member States prohibited by Articles 28, 49 of the EC Treaty. In the preliminary ruling C-405/98 it decided that a prohibition of all advertising directed to consumers is liable to reduce potential sales of non-Swedish products in the Swedish market. Specifically, the decision held that this negative effect is bigger for foreign than for Swedish products, essentially because consumers are more familiar with the latter.

Nevertheless, the ECJ ruled that the ban on alcohol advertisement could be justified by the goal to protect public health, a general interest ground recognized by Articles 30, 46 of the EC Treaty. According to the Court, the ban would be justified if it were proportionate to the objective to be achieved and if it did not constitute either a means of arbitrary discrimination or a disguised restriction on trade between Member States. According to the ECJ there was no evidence of arbitrary discrimination or a disguised restriction on trade in this case.

The ECJ deferred to the Swedish court (which had asked for the preliminary ruling) the question as to whether or not the objective sought might be achieved by prohibitions or restrictions having less effect on intra-EC trade. The Court also left to the Swedish court the decision as to whether the ban on advertising was proportionate. Specifically, the ECJ acknowledged that the question of proportionality "calls for an analysis of the circumstances of law and of fact which characterize the situation in the Member State concerned, which the national court is in a better position than the Court of Justice to carry out." Recently, the relevant Swedish court decided that the alcohol advertising ban indeed was necessary and proportionate.

WTO agreements do not explicitly contain a proportionality test. Nevertheless, as previously described, the AB has recently employed certain limited elements of a proportionality test when applying necessity tests. For example, the AB has used the necessity test to consider the importance of the objective pursued in determining its WTO compliance. Thus, at least concerning those measures that are considered *dispensable* in the first place,[30] this recent jurisprudence veers toward a kind of proportionality testing.

However, the AB also stops short of applying a full-fledged EC-style "proportionality test". A proportionality test requires weighing the goals of the measure against the effects of the protection. As a result, it would be less deferential than

necessity tests. The following section describes WTO Members' current discussions on whether to install a proportionality test in the legal framework of the GATS.

3 ARTICLE VI.4 OF THE GATS

Whether or not to negotiate a proportionality test is a controversial issue in the current VI.4 negotiations on domestic regulation. This section first reviews the existing necessity language in Article VI.4 and then, in that context, discusses the two most prominent negotiating proposals: the EC proposal to include a proportionality test for measures relating to technical regulations, licensing and qualification requirements and the Japanese Draft, which contains several differently formulated necessity tests, but which nevertheless stops short of including a specific proportionality test.

3.1. THE NECESSITY TEST IN ARTICLE VI.4 OF GATS

The GATS establishes a legal framework for trade in services with the goal of progressively liberalizing such trade. WTO Members are currently pursuing this goal through a set of far-reaching negotiations, covering essentially all services sectors - from the provision of water to financial and telecommunications services.[31]

The GATS is made up of two distinct parts. First, a "framework of principles" outlines the general obligations (e.g. transparency and "most favored nation" treatment) that apply to all Members' measures (laws, rules, regulations, procedures, decisions or administrative actions) affecting trade in services.[32] This framework also includes the specific obligations (i.e. market access and national treatment). Second, Members' "schedules of specific commitments" list in which services sectors and sub-sectors and under what conditions individual Members agree to be bound. These decisions are made in so-called market access negotiations.

One of the challenges of services trade liberalization is that domestic regulations, rather than border tariffs, create the primary barriers to trade, which can pit the preservation of national authority against WTO objectives. Accordingly, WTO Members' efforts to eliminate such "internal" trade barriers have concerned domestic regulators and civil society groups.[33] Article VI, entitled "domestic regulation", has been at the center of such concern. Article VI.1 specifies that domestic regulations should be administered in a reasonable, objective and impartial manner. Article VI.4 requires Members to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services. Thus, Article VI.4 contains a rules-type necessity test - albeit somewhat differently phrased.

Article VI.4 does not require Members to submit domestic regulations to the WTO for approval. However, in the event of a dispute, necessity may be a decisive factor in determining whether a domestic measure is deemed to be consistent or inconsistent with WTO agreements. Given its importance in establishing WTO compliance, it would seem vital that the term "necessity" be clearly defined; yet, a definition is currently lacking. Legitimate concerns have been raised that this uncertainty may have a "chilling effect"[34] on national regulations. Consequently, some Members would like to define the necessity test.

Article VI.4 of GATS

With a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, the Council for Trade in Services shall, through appropriate bodies it may establish, develop any necessary disciplines. Such disciplines shall aim to ensure that such requirements are, inter alia:

(a) based on objective and transparent criteria, such as com petence and the ability to supply the service;

(b) *not more burdensome than necessary* to ensure the qual ity of the service;

(c) in the case of licensing procedures, not in themselves a restriction on the supply of the service

Article VI.4 could be said to contain a mandate to such effect. Members are currently negotiating future disciplines for domestic regulations in the GATS WPDR,[35] and (footnote needs to be moved over to the left) one of the most controversial issues is the definition and scope of the necessity test. Yet, calls for clarification have faced stiff resistance from some WTO Members and civil society groups, who worry that "clarification" could be used to change the nature and scope of the current necessity test, and thereby create additional constraints for domestic regulators. These concerns are most intensively raised over the EC's proposal to introduce a proportionality test in future VI.4 disciplines.

3.2. THE EC PROPOSAL TO INTRODUCE PROPORTIONALITY INTO FUTURE ARTICLE VI.4 DISCIPLINES

In a communication to the WPDR in May 2001, the EC states that it had "introduced the concept of proportionality into the discussion". The EC communication suggests that "[a] measure should be considered not more trade-restrictive/not more burdensome than necessary if it is not disproportionate to the objective[s] pursued". It also explicitly states that "…the degree of trade-restrictiveness meeting the requirements of necessity will depend on, and be assessed against, the specific objective[s] pursued, while the validity, or rationale, of the policy objective[s] must not be assessed."[36]

If adopted, the EC proposal would effectively turn the Article VI.4 necessity test into a proportionality test. The EC proposal is problematic, not only because it introduces the

word "proportionality" into WTO language, but also because it would explicitly authorize the weighing and balancing of a measure's trade restrictive effects against the policy objectives pursued. In practice, balancing the trade restrictiveness of a measure against its intended policy objective could very likely require questioning the value of that objective - even though the EC proposal states otherwise. Moreover, as shown in *EC - Asbestos* and *Korea - Beef*, the importance of objectives has already proven to be a deci sive factor in whether or not a measure passes the necessity test.

Following the EC approach would boost the proportionality aspects of the necessity test and expand the prerogatives of WTO tribunals at the expense of domestic decision-making ability. This would be particularly problematic because of the importance of domestic regulation of the provision of services, the need for diverse approaches and the role of sub-central, (i.e. regional and municipal) and other regulatory entities. Concerns about these issues appeared to have momentarily stalled progress on the European proposal; however, more recently, Japan revitalized the debate.

Measures Potentially Covered by Future VI.4 Disciplines

According to Article VI.4 future disciplines on domestic regulation will cover "measures relating to qualification requirements and procedure, technical standards and licensing requirements". These terms have not been formally defined under GATS, but a 1996 Secretariat background note provided certain definitions in the context of professional services:

- **Qualification requirements** are substantive requirements which a professional service supplier is required to fulfill in order to obtain certification or a license. E.g. education, examination requirements, practical training, experience or language requirements.
- **Technical standards** are requirements which may apply both to the characteristics or the definition of the service itself and to the manner in which it is performed. E.g. a standard may stipulate the content of an audit, or lay down rules of ethics to be observed by an auditor.
- **Licensing requirements** are requirements, other than qualification requirements, with which a service supplier is required to comply in order to obtain formal permission to supply a service; I.e. residency requirements, fees, establishment or registration requirements.

Source: WTO, Note by the Secretariat, *The Relevance of the Disciplines of the Agreements on Technical Barriers to Trade (TBT) and on Import Licensing Procedures to Article VI.4 of the General Agreement on Trade in Services*, S/WPPS/W/9 at para 4 (Sept. 11 1996).

3.3. THE JAPANESE DRAFT ANNEX ON DOMESTIC REGULATION

In March, 2003, Japan presented a Draft Annex on Domestic Regulation of services to WTO Members in the WPDR.[37] Among other issues, the Japanese Draft contains a series of differently formulated necessity tests. This section reviews the different formulations of necessity tests, and then highlights starting points for an analysis of the Japanese Draft; finally, it addresses the Japanese Draft from a strategic perspective and in light of the current dynamics in the WTO's services negotiations.

The Japanese Draft contains a series of necessity tests, each formulated differently and applying to different types and aspects of domestic regulation. For example, for all measures of general application relating to licensing requirements and procedures, qualification requirements and procedures, as well as technical standards (emphases added):

- para 6, addressing the preparation, adoption and application of such measures, establishes that "[e]ach Member shall ensure…that measures of general application…are not prepared, adopted or applied with a view to or with the effect of creating *unnecessary barriers to trade* in services."
- para 6 also states that "[f]or this purpose, each Member shall ensure that such measure are *not more burdensome than necessary* in order to fulfill its national policy objectives."
- para 7 reads that "[e]ach Member shall examine….the possibility of modifying or terminating existing measures of general application…if the circumstances or objectives giving rise to their adoption no longer exist or if new circumstances or objectives can be addressed in a *less trade-restrictive manner*."

Both the obligations in paras 6 and 7 only apply in sectors where specific commitments are undertaken.

In addition, the Japanese Draft also contains more specific provisions for licensing requirements (part V), licensing procedures (part VI), qualification requirements (part VII), qualification procedures (part VIII) and technical standards (part IX). Specifically, (emphases added):

- para 15, addressing *residency requirements for licensing* not subject to scheduling under Article XVII, establishes that "…each Member shall consider, whether less trade restrictive means could be employed to achieve the purpose for which these requirements were imposed, taking into account costs and local conditions."
- para 18, addressing *licensing procedures*, establishes that "…each Member shall ensure that application procedures and the related documentation are *not more burdensome than necessary* to ensure that applicants fulfill qualification and licensing requirements."
- para 18 also establishes that "[e]ach Member shall endeavor not to require more documents than are *strictly necessary* for the purpose of such licensing, and shall endeavor not to impose unreasonable requirements regarding the format of such documentation."

Again, these obligations would only apply to sectors where specific commitments are undertaken. In addition, aside from the general rules mentioned above, only licensing requirements and procedures are subject to provisions with necessity language.

The Japanese Draft's provisions on qualification requirements, procedures and technical standards still contain language that could imply necessity, even though the word itself is not explicitly stated. Specifically, para 28 addressing technical standards establishes that "[e]ach Member shall ensure that measures relating to technical standards are prepared, adopted and applied *only* to fulfill national policy objectives including protection of consumers and establishment of minimal standards to ensure the quality of the service."[38]

The Japanese Draft clearly warrants careful attention from WTO Members and trade policy makers in Geneva and in WTO Members' capitals. Ideally, national policy makers in areas other than trade policy and civil society groups should also embark on a thorough analysis of the impact that this proposal could exhibit on domestic regulatory prerogatives.

As an initial starting point for such analysis, the Japanese Draft:[39]

- does not explicitly suggest a proportionality test or elaborate on possible elements or criteria for a necessity or proportionality test;
- contains several layers of differently formulated necessity tests, some applying generally to the "preparation, adoption and application of measures" (paras 6 and 7) and others applying more specifically to either licensing requirements (para 15), procedures (para 18) or technical standards (para 28), although the latter does not refer to the concept of necessity in the strictest sense;
- contains necessity tests that may exhibit different degrees of legal obligation on WTO-Member governments, e.g. language stating that Members "shall ensure" (paras 6, 18, 25 or 28) "shall examine" (para 7), "shall consider" (para 15), and "shall endeavor" (para 18);
- does not contain the concept of "legitimate policy objectives", but, rather, introduces the new concept of "national policy objectives", providing an indicative list of suggestions for such national policy objectives that contains consumer protection and the quality of the service (para 28);
- contains differently worded necessity tests, such as, "unnecessary barriers to trade" (para 1, entitled "objectives"); "not more burdensome than necessary" (para 6 for general measures); "in a less trade-restrictive manner" (para 7 for general measures) or with "less trade restrictive means" (para 15 for licensing requirements);
- introduces the new concepts of a measure being "strictly necessary" (para 18 for licensing procedures) or being prepared, adopted and applied "only to fulfill national policy objectives" (para 28 for technical standards) or constituting "an impediment in themselves to practicing the relevant activity" (para 25 for qualification procedures).

What Are the Advantagesand Disadvantages of the Japanese Approach?

The following are among the elements that impact WTO tribunals' latitude for weighing and balancing different policy objectives and values:

Japan's proposal seems to adopt - at least partially - a cautious and deferential approach to the sensitive questions of domestic choices about legitimate policy objectives. Specifically, the Japanese text allows the pursuance of any *national* policy objective, without demanding that WTO law recognize the objective (para 6);

The Japanese Draft could be interpreted to imply that *local* conditions will play a role when weighing aims and costs, which could indicate that the balancing standard will be deferential; specifically, with respect to residency requirements, it suggests that costs and *local conditions* are to be taken into account when determining necessity (para 15); however,

Japan's proposal also appears to introduce a new, stricter category of necessity tests, which could further curtail the relative freedom that Members current enjoy under the language of necessity. Specifically, it mandates that WTO Members shall not demand more documents that are *strictly* necessary for the proof of qualification and licensing requirements (para 18).

The Japanese Draft, insofar as its provisions apply to the general preparation, adoption and application of measures, specifically suggests that "…Members shall examine the possibility of modifying or terminating exiting measures….if new circumstances or objectives can be addressed in a less trade-restrictive manner." Similarly, the Japanese Draft does not apply "to measures regulating the entry of natural persons into, or temporary stay in, a Member's territory, includ ing those measures *necessary* to protect the integrity of, and to ensure the orderly movement of natural persons across, its borders." (emphasis added)

Finally, it is important to place the Japanese Draft in the context of the dynamics of current service negotiating. From this perspective, the Draft introduces a certain degree of flexibility, which may in part be strategic, since Members are more apt to conduct successful negotiations if the target outcome is flexible.[40] Offering necessity tests that exhibit different degrees of legal obligation is one flexible aspect of the Japanese proposal. While, in some cases, Members "shall ensure", in other cases, they only "shall examine", "shall consider" or "shall endeavor" a certain necessity-related outcome. This flexibility might make it easier for Members to agree on various suggested disciplines, which would allow them to move forward on issues that have been difficult to resolve under the looming possibility of outcomes that would be, strictly speaking, legally binding.

Overall, these and many more points warrant detailed attention from policy makers, civil society groups and affect-

ed stakeholders throughout the future months of negotiating processes. Specifically, careful analysis is needed on whether new language and concepts, be they newly formulated necessity tests or proposed proportionality tests, further constrain domestic regulatory prerogatives.

4. CONCLUSIONS

Proportionality testing in the WTO could allow panels and the AB to outlaw measures whose trade restrictive effects they consider to be excessive or "out of balance" with the positive, non-economic policy goals the measure is designed to promote.

The rationale that some trade policy makers offer to support new constraints on government regulation of services is that international disciplines would require governments to reform inefficient regulatory systems and eliminate "behind-the-border" rules that impede services trade. While certain regulatory reforms in the services sector could benefit consumers and the general public, there is much concern that a proportionality test - curtailing Members' right to establish and pursue objectives - is not the most appropriate way of achieving such reform.

Such a test would allow for the weighing of, and consequent selection between, different means of achieving several legitimate objectives. Giving the WTO discretion to place certain objectives and different methods of achievement above others does not guarantee adequate consideration of non-economic policy objectives.

Rather, a flexible and deferential test for assessing the WTO compatibility of domestic regulatory measures is required. Flexibility and deference are important to ensure that individual WTO Members can regulate effectively to protect the environment, consumers and human health. For this reason, a proportionality test for measures relating to technical regulations, licensing and qualifications requirements would be inappropriate and would imply changes of a constitutional dimension.

WTO Members should ensure that any new disciplines under Article VI.4 recognize the broad set of legitimate policy objectives a WTO-Member State may wish to pursue. To that end, some Members have suggested including an illustrative, non-exhaustive list of legitimate objectives in order to clarify the concept of necessity. Others have argued that such a list would constrain, rather than strengthen, Members' prerogatives to autonomously set legitimate policy objectives, and that it is potentially hard for the more than 140 WTO Members to agree on a list of legitimate domestic policy objectives.

In addition, some have devised draft disciplines suggesting different levels of legal obligation for different necessity tests, some of which may be considered stricter than others.

Finally, some have questioned the overall value of clarifying the nature, content and criteria of the necessity test.

While clarification may sound like a positive step toward removing the chilling effect of current uncertainty, any clarification should not result in a necessity test that imposes stricter limits on domestic regulatory prerogatives or expands the decision-making powers of WTO tribunals.

In any case, given the potential impact these future disciplines might have on the scope of domestic policy making, WTO Members must tread cautiously. It is crucial to have a well-informed decision-making process based on broad and open discussions between civil society, policy makers and other affected stakeholders, both at the national and international levels.

5. RECOMMENDATIONS

Before adopting international, legally binding obligations, trade policy makers and national level regulators must thoroughly and comprehensively assess the potential effects such disciplines could have on domestic regulatory prerogatives. Such an assessment has to be carried out in full transparency, involving academics, civil society groups and other affected stakeholders. In particular, such an assessment must analyze:

- how the concepts of proportionality and balancing have been used in a national context;
- the impact that the meaning and interpretations of terms such as necessity, proportionality and balance within WTO agreements have on domestic regulatory prerogatives;
- the specific impact of the EC's proposal to introduce a proportionality test into Article VI.4 of the GATS;
- the specific impact of the Japanese Draft and the differently-formulated necessity tests contained therein;
- which national regulatory bodies will be affected by any possible changes or new disciplines; and
- which types of domestic regulations may be affected by these changes.

WTO Members have, to some extent, started addressing these questions. To be effective, however, these discussions need to be open and transparent and allow for the input and involvement of regulators, civil society and other affected stakeholders. Hastily adopting new disciplines before affected stakeholders are able to thoroughly analyze and reflect on pertinent issues would likely prove disastrous for many countries and could jeopardize the positive effects that the disciplines aim to achieve.

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TABLE OF ACRONYMS

AB	Appellate Body
DSB	WTO Dispute Settlement Body
EC	European Community
ECJ	European Court of Justice
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
NGOs	Non-governmental Organizations
SPS	Agreement on the Application of Sanitary and Phytosanitary Measures
TBT	Agreement on Technical Barriers to Trade
TRIPS	Agreement on Trade Related Aspects of Intellectual Property Rights
US	United States of America
WPDR	Working Party on Domestic Regulation
WPPS	Working Party on Professional Services
WTO	World Trade Organization

Endnotes

1. This CIEL discussion paper builds upon and expands analysis undertaken in Neumann, J. & Türk, E., *Necessity Revisited - Proportionality in WTO Law after* Korea-Beef; EC-Asbestos *and* EC-Sardines, Journal of World Trade, Vol. 37 No. 1 (Feb. 2003), Kluwer Law International. Any comments are very much appreciated, please send to etuerk@ciel.org.

2. Marrakesh Agreement Establishing the World Trade Organization (WTO), Legal Instruments - Results of the Uruguay Round vol. 31, 33 I.L.M 81 (1994) [hereinafter WTO Agreement].

3. While the "cost-benefit analysis" concept in US law could potentially prove relevant to the formation of new WTO disciplines, it is not addressed in this paper.

4. Some accuse WTO processes of artificially creating consensus in the run up to and during Ministerial Conferences.

5. Note however, that Article 3.2 of the WTO's Disputes Settlement Understanding establishes that "[r]ecommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements." *Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU)*, Article 3.2 (Annex 2 to the WTO Agreement).

6. The word "necessary" normally connotes something "which is indispensible; an essential, a requisite, etc." THE NEW SHORTER OXFORD ENGLISH DICTIONARY 1895 (5th ed. 1993).

7. BLACK'S LAW DICTIONARY 928 (5th ed. 1979).

8. *See*, for example: Article XI:2 lit. b), c), Article XX lit. a), i), and Article XXIV:5 of the General Agreement on Tariffs and Trade (GATT), Annex 1:A to the WTO Agreement; Article XIV lit a), b), c) and Article VI:4 of the General Agreement on Trade in Services (GATS), Annex 1B to the WTO Agreement; Articles 3.2, 8.1, 27.2 of the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), Annex 1C to the WTO Agreement; Article 23:2 of the Agreement on Government Procurement (GPA), Annex 4 to the WTO Agreement.

9. For a thorough description of jurisprudence on these necessity tests see: WTO Secretariat, *GATT / WTO Dispute Settlement Practice relating to GATT Article XX, Paragraphs (b), (d) and (g)*, WT/CTE/W/203, 8 Mar. 2002; *see* Neumann, J. and Türk, E., *supra* note 1.

10. *US - Sect. 337 of the Tariff Act of 1930*, para. 5.26, BISD 36S/345, (adopted 7 Nov. 1989).

11. *Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes,* para. 75, BISD 37S/200 (adopted 20 Feb. 1990).

12. US - *Standards for Reformulated and Conventional Gasoline*, paras. 6.25-6.28, WT/DS2/R [hereinafter US - Gasoline].

13. This concern was expressed by many civil society organizations critical of the WTO, as well as by academics and professionals working in the area of international trade. *See* A. Appleton, *GATT Article XX's chapeau: A disguised 'Necessary' Test?*, RECIEL 6 (1997); D. ESTY, GREENING THE GATT: TRADE, ENVIRONMENT, AND THE FUTURE (1994); T. Schoenbaum, *International Trade and Protection of the Environment: The Continuing Search for Reconciliation*, AJIL 91 (1997), and R. HOWSE & M. TREBILCOCK, THE REGULATION OF INTERNATIONAL TRADE (1999).

14. *Korea - Import Measures on Fresh, Chilled and Frozen Beef,* WT/DS161, 169/AB/R [hereinafter *Korea - Beef]*.

15. *Id*. at para. 161.

16. *Id*. at para. 161.

17. *Id*. at para. 164.

18. *EC - Measures Affecting Asbestos or Products Containing Asbestos*, para. 171, WT/DS135/AB/R [hereinafter *EC - Asbestos*].

19. There are some concerns regarding the transferability of an interpretation of a necessity test which is combined with closed and explicitly listed legitimate objectives, such as Article XX (b) GATT, to a necessity test provision with an open-ended list of legitimate objectives, such as Article XX (d) GATT. For an explanation, Neumann, J. & Türk, E., *see supra* note 1, at section III.1.

20. *EC - Asbestos, supra* note 18, at para. 172 (quoting *Korea- Beef*, supra note 14, at para. 162).

21. While WTO agreements currently do not include an explicit proportionality test, one aim of this paper is to demonstrate how existing (or future) necessity tests could be amended or interpreted to allow the type of balancing that characterizes proportionality tests. Section 2.2 of this

paper further elaborates on the definition of a "proportionality test" and its distinction from a necessity test.

22. This may be the case when dealing with a necessity test which contains an open-ended list of legitimate objectives. TBT Article 2.2 TBT and GATT article XX (d) contain such necessity tests.

23. In *EC - Sardines*, the panel and the AB explicitly state that an open-ended list of legitimate objectives allows for an investigation of the legitimacy of the policy goal in question. "Furthermore, we share the view of the Panel that the second part of Article 2.4 implies that there must be an examination and a determination on the legitimacy

of the objectives of the measures." *EC - Trade Description of Sardines*, para. 286, WT/DS231/AB/R [hereinafter *EC - Sardines*].

24. In *Japan - Alcoholic Beverages*, for example, the AB stresses when interpreting "like products" that the extent of the concept of likeness, to which several of the WTO agreements refer, "must be determined by the particular provision in which the term 'like' is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply." *Japan - Alcoholic Beverages*, 21, WT/DS8/AB/R, 1Nov. 1996 [hereinafter *Japan - Alcoholic Beverages*].

25. WTO, Informal Note by the Secretariat, WPDR; *Application of the Necessity Test: Issues for Consideration*, Job No. 5929 (19 Mar. 2000).

26. Agreement on Sanitary and Phytosanitary Measures (SPS), Annex 1A to the WTO Agreement.

27. Consolidated Version of the Treaty Establishing the European Community, Article 5 (ex Article 3b) , *available at* http://europa.eu.int/eur-lex/en/treaties/dat/ec_cons_treaty_en.pdf (last visited 18 August 2003).

28. Although the ECJ often uses the terms "suitability" or "appropriateness" when evaluating the effectiveness of a measure (e.g. ECJ Case C-101/98, UDL, (1999), E.C.R. I-8841, para. 30), the term "effectiveness" is preferable, because the former two terms can be misunderstood as indicating a proportionality *strictu sensu*; *see EC - Sardines, supra* note 23, at para. 7.116. for a similar terminology in the context of Article 2.4 TBT.

29. The relevant provision for trade in goods in the Consolidated Version of the Treaty Establishing the European Community is Article 30, and for trade in services Articles 53, 45, and 46. In the case of trade in goods, the additional legitimate objectives recognized by the ECJ include, among others, public policy and security, health, national heritage, and industrial and commercial property.

30. As shown above (2.1.), weighing and balancing within the necessity tests of Articles XX (b) and (d) of GATT refer only to to measures that are “dispensable.” *See also Korea - Beef*, *supra* note 14, at para. 164.

31. Whether the GATS also covers public services is a controversial question, which raises concerns surrounding access to water, basic education, and health services. *See* Krajewski Markus, *Public Services and the Scope of the GATS*, a CIEL research paper available at http://www.ciel.org for a discussion of the scope of the GATS and Article I.3 (b).

32. A similarly controversial aspect of GATS is its extreme, broad coverage of domestic regulatory measures, which essentially place disciplines on all measures affecting trade in services. *See* Fuchs, Krajewski, &Türk, *The General Agreement on Trade in Services (GATS) and future GATS-Negotiations - Implications for Environmental Policy Makers*, a UBA Study, (Apr. 2003) ch. 4 for analysis.

33. *See* Sinclair, S., *GATS: How the World Trade Organization's new "services" negotiations threaten democracy,* Canadian Centre for Policy Alternatives, Ottawa (2000); Woodroffe J., *GATS: A Disservice to the Poor*, World Development Movement, London (Jan. 2002); *see also*, Howse, R. & Türk, E., *The WTO Negotiations on Services (GATS): The Regulatory State up for Grabs*, paper presented at the conference, "From Doha to Kananaskis: The Future of the World Trading System and the Crisis of Governance," York University & University of Toronto, Ontario, Canada (1-3 Mar. 2002). *See* WTO, Secretariat, *GATS - Facts and Fiction* (Mar. 2001), www.wto.org, for a response of the WTO Secretariat to early civil society critique.

34. Uncertainty regarding the scope and content of the necessity test and the potential for a challenge involving such an unclear provision in front of the WTO dispute settlement system may effectively inhibit or halt domestic regulatory actions; see also De Burca, Grainne & Scott, Joanne, The Impact of the WTO on EU Decision-Making, http://www.jeanmonnetprogram.org/papers/00/000601.html (2000).

35. The WPDR began its work in 1999 after taking over for the GATS Working Party on Professional Services (WPPS). See the WTO unpublished document "Summary of the discussions on the checklist of issues for WPDR," JOB(02)/3/Rev.3 (3 Dec. 2002) for an overview of the work WTO Members have carried out to date on that issue in the WPDR. Unfortunately, this summary is not available to the general public.

36. WTO, Communication from the EC and their Member States, WPDR, *Domestic Regulation: Necessity and Transparency*, para. 17, S/WPDR/W/14, 1 May 2001.

37. WTO, Communication from Japan, WPDR, *Draft Annex on Domestic Regulation*, Job(03)/45,3 Mar. 2003). This paper refers to the revised draft (3 May 2003).

38. Again, this is only the case"[i]n sectors where specific commitments are undertaken." *Id*.

39. Note that this paper does not aim to establish a comprehensive list of issues that merit attention in the Japanese Draft. Rather, this paper aims to offer initial comments focusing on aspects relevant to questions of necessity, proportionality, and balancing. It is also crucial to look at other issues, including the Japanese Draft's approach to mode 4.

40. Mashayekhi, M. & Türk, E., *The WTO Services Negotiations: Some Strategic Considerations*, para. 41f, Trade-Related Agenda, Development and Equity, Occasional Papers 14, South Centre (Jan. 2003).