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# **Product differentiation under the WTO**

An analysis of labelling and tariff or tax measures  
concerning farm animal welfare

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Product differentiation under the WTO; An analysis of labelling and tariff or tax measures concerning farm animal welfare

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This report examines the possibility of giving preferential treatment to imports of meat products that meet improved standards in terms of animal welfare in production. Three specific forms of preferential treatment are considered here as possible measures for increasing levels of animal welfare in meat production in the EU and its exporting partners: labelling of products (either voluntary or compulsory), differentiated import tariffs and differentiated consumer taxes. The likely admissibility of such measures under WTO rules is assessed by means of an analysis of previous decisions by WTO dispute settlement panels. It is concluded that all of the measures analysed have a possibility of being upheld, based on a defence relying on Article XX of the GATT and perhaps also the TBT Agreement. While the incentives offered by labelling could be reinforced with differentiated tariffs or taxes, these financial instruments involve various additional complications. They could best be considered after the possibilities of regulated labelling schemes have been exhausted.

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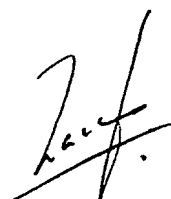


## Preface

This report addresses a topic of increasing importance in international trade in agricultural products: sustainability criteria in production methods. In the specific case of animal welfare, the EU has been a global leader in promoting improved standards intended to reduce suffering of animals on the farm, during transport and finally at the time of slaughter. These efforts are visible in more stringent requirements for domestic production and in the position adopted by the EU in international discussions at the World Organization for Animal Health (OIE) and the World Trade Organization (WTO). The Ministry of Agriculture, Nature and Food Quality (LNV) of the Netherlands has requested LEI to investigate the possibility to apply mandatory labelling and tariff or tax differentiation to meat products, based on the standards of animal welfare in farm production, whether foreign or domestic. The possibility of such measures has been raised earlier, including in advice from the Social and Economic Council (SER) of the Netherlands.

The research presented in this report is the result of a fruitful and innovative partnership between LEI and Mr Jacques Bourgeois, a partner with the legal firm Akin, Gump, Strauss, Hauer and Feld in Brussels. Mr Bourgeois is a highly respected authority on various areas of European and international law, in particular trade law. He has assisted clients in WTO dispute settlement proceedings and has himself presided over a WTO dispute settlement panel. In this report, he applies his knowledge of previous GATT and WTO cases to assess whether the contemplated measures would be challenged under the WTO as well as the likelihood of a successful defence. His findings are combined with an analysis by the LEI of the likely effectiveness of the measures, and recommendations for policy emerge from this integrated analysis.

This research was financed by the Dutch Ministry of Agriculture, Nature and Food Quality, primarily through two of its policy-supporting research programmes: International Co-operation (404) and Social & Economic Issues in an (Inter-)National Context (411). I would very much like to thank all those contributed to the study, in particular the members of the advisory commission at the Ministry who provided guidance and feedback on the results: Henk Massink (International Affairs), Rien Huige (now with the Permanent Mission of the Netherlands to the WTO), Jean Rummenie (Industry and Trade) and Jacques Urselmann (Taskforce Economie).



Prof. Dr. L.C. Zachariasse  
Director General LEI B.V.





## Summary

This report examines the possibility of giving preferential treatment to imports of agricultural products that are 'sustainably-produced' relative to those that are deemed to be less sustainably produced. Sustainable production is defined as processes and production methods (PPMs) that meet specific standards with respect to criteria such as environmental impacts, animal health, and animal welfare. The issues are examined in the context of animal welfare in meat products where preferential treatment would be given to meat products that meet improved standards in terms of animal welfare. The motivation for giving preferential treatment to imports, and potentially also domestic production, of such products is, at the broadest level, to improve the sustainability of production methods for agricultural products both in the EU and its trading partners.

In WTO terminology, 'processes and production methods' (PPMs) are defined as the way in which products are manufactured or processed. Animal welfare is an example of a non-product related PPM issue, which refers to fact that meat products are generally not distinguishable according to the level of animal welfare in production. In other words, non-product related PPMs do not affect the physical characteristics of the final product. Policy measures related to non-product related PPMs are generally considered to fall outside specific WTO agreements dealing with product standards, such as the Agreement on Sanitary and Phytosanitary Measures (SPS) and the Agreement on Technical Barriers to Trade (TBT), and thus potentially conflict with WTO principles.

Animal welfare receives more legislative attention in the European Union (EU) than in many other regions of the world. Animal welfare standards for farm production, transport of farm animals and slaughter are generally taken to be higher in the EU than in meat-producing countries exporting to the EU, particularly developing countries. This research concerns then differentiation among meat products on the basis of animal welfare. In addition to the regulatory process standards on animal protection, there is a growing array of private standards in the retail of animal products in the EU. But, as competition takes place largely on the basis of price, animal welfare in the production of most of the animal products produced and sold in EU supermarkets is at the minimum, regulatory level.

From a policy perspective, the preferred situation is one in which countries can agree on common standards and institutionalise these in the form of international agreements. But such a process of negotiating an international treaty can take a very long time, and the question is whether other options are available in the interim. Countries are free to set such standards for their own production but these have a more limited effect when products are traded internationally and when higher standards imply increased production costs. In the case of the EU - where imports account for 7-8% of the supply of beef and poultry - then improving domestic PPM standards may simply result in increased imports of less sustainable products.

Three specific forms of preferential treatment are considered here as possible measures for product differentiation that aim to improve animal welfare standards in the EU and

its exporting partners: labelling of products (either voluntary or compulsory), differentiated import tariffs and differentiated consumer taxes.

Two situations can be distinguished: one in which measures concentrate on improved animal welfare levels in foreign countries to reduce the gap with European standards, and one in which measures aim in addition to stimulate improvements in standards in foreign countries and also in European production above the minimum required. A supervised (or regulated) labelling scheme could be applied in either situation to provide consumers with more information and hopefully influence them to purchase meat produced with higher levels of animal welfare. In the first situation, labels could distinguish between products that do and do not meet the European minimum standard. Such labelling could be regulated and supervised by government authorities, but left as a voluntary decision for producers, or be made mandatory. This labelling is intended to stimulate foreign producers to adopt EU standards by making it clear to consumers that such products differ from those produced in the EU. In the second, supervised labelling of products that meet standards higher than the minimum required could be introduced, such as has been proposed in the Netherlands with a welfare index or point system ('stippensysteem'). The aim of such labelling is to also provide an incentive for domestic producers to increase animal welfare standards above the minimum requirement.

In addition to providing more information to consumers by means of labelling, there is also the possibility of using financial mechanisms such as taxes or tariffs, to reduce the price difference that consumers of products with higher standards must pay. Existing or new taxes and/or tariffs could be differentiated according to PPM standards to compensate for higher production costs associated with improved standards. Differentiating tariffs means either a lower, i.e. preferential, import duty (relative to the current applied rates) for meat imports meeting the EU minimum standard, a higher duty for those not meeting the EU minimum standard, or a combination of both. Similar differentiation is conceivable with a tax-based measure, such as excise taxes. Whereas differentiated tariffs would aim to improve standards in foreign countries (the first situation), a differentiated tax measure could also be used to stimulate improvements in animal welfare in production within the EU. In practice, differentiated taxes or tariffs would be applied in combination with some form of labelling, as a means of communicating to the consumer the purposes of the policy.

### *WTO Rules*

Although the intended aim of the measures is to increase levels of animal welfare in meat production in the EU and countries exporting to the EU, they will probably affect trade flows and so their consistency with WTO rules and principles needs to be investigated. Each of the measures can be seen as discriminating between different types of traded products, whether between meat produced in the EC and elsewhere, or between meat produced in various non-EC countries. The measures could therefore be subject to a challenge in the WTO's dispute settlement procedures. Various possible defences are conceivable including:

- Meat products with higher standards of animal welfare are not 'like' other meat products. If the products are considered to be different, then measures may be applied to

- one group of products and not to the other. WTO panels assess whether products are 'like' on the basis of criteria that include the properties, nature and quality of the products, its end-uses, consumer tastes and habits, and tariff classification;
- The measures are permitted under the WTO SPS Agreement as necessary to protect animal health and/or the WTO TBT Agreement as the least trade restrictive means of achieving the goal of improving animal welfare. Trade-distorting measures may be permitted under the SPS Agreement if they are necessary for the protection of animal health, plant health or food safety. The TBT Agreement requires that regulations do not restrict trade more than is necessary to achieve the stated aim;
  - The measures are necessary to protect public morals and animal health, and so can be justified under Article XX GATT which allows, under certain conditions, measures to deviate from the general principles of the GATT.

Detailed analysis of WTO rules and recent dispute cases indicates the first defence has little likelihood in succeeding. Meat products produced with different levels of animal welfare would probably be considered as 'like' products. The second defence may be upheld but depends, in the case of the SPS Agreement on scientific evidence demonstrating that the measures protect animal health, by preventing risk of pests and diseases. But this has not yet been generally accepted. The TBT Agreement would, in the absence of agreed international standards on animal welfare, require that the EU standards can be justified on the basis of a scientific assessment. This defence, which follows from the current lack of internationally recognised standards for animal welfare, may well be upheld, if it can also be shown that the measures are not more restrictive of trade than necessary. The third defence tentatively offers the strongest argument, particularly by justifying the measures as necessary to protect public morals, where it is argued and can be demonstrated that animal welfare is an issue of public morals in the EU.

The likelihood of a case being brought to the WTO would also differ among the various measures. Labelling has the least chance of leading to a complaint, as well as the greatest chance of being upheld in a dispute settlement procedure. But while differentiated tariff reductions or differentiated tax measures could more quickly be claimed as not consistent with Articles I or III GATT, a defence of such measures under Article XX GATT may have a good chance of succeeding.

### *Effectiveness*

The analysis of the likely effects of the measures, such as labelling, is only undertaken in the first instance in a qualitative sense. Predicting the effects more precisely in terms of relative shares of various segments of the meat market, and thus in raising animal welfare in meat production, is possible only with more detailed analysis of consumer preferences and cost considerations in raising standards.

Labelling of meat meeting the EU minimum standard can be expected to have some positive effect on the level of animal welfare in PPMs in exporting countries. This would also be the case for a regulated (supervised) labelling scheme for one or more gradations of better PPMs, such as with a point system. But the extent to which such a scheme would improve animal welfare in the EU or other countries is harder to predict. Based on existing,

though limited, research on consumers, relatively little demand for differentiated meat products embodying higher standards of animal welfare in the EU can be expected. Nonetheless such a scheme would probably incorporate the same positive effects on foreign producers as the simpler labelling of a minimum standard which would be either implicitly or explicitly included in the more elaborate scheme.

Two policy measures have been proposed for reinforcing labels and standards with financial measures: differentiated tariffs and differentiated taxes, in particular consumer taxes. The main difference between tariffs and taxes is that tariffs would be a border measure differentiating only between domestic and foreign products according to animal welfare in production methods, whereas taxes would apply to all products on the domestic market.

Differentiated tariffs primarily affect foreign products and could be used to provide greater incentives to meat producers in countries exporting to the EU to adopt its minimum standard for animal welfare. The additional effects of differentiated tariffs on market shares and prices is likely to be modest while a considerable improvement in standards among exporters could probably be expected. Tariffs could be either increased for products not meeting EU standards or decreased for compliant products. The principal difficulties with tariffs concern the renegotiation of bound rates in the case of tariff increases, or the increased competition on the domestic market in the case of decreases.

Differentiated taxes (or purchase rebates) would provide much stronger incentives for producers in the EU and other countries to further improve their animal welfare standards in PPMs. But designing and implementing such a system poses even more difficulties, some of which may be insurmountable. Setting different VAT rates would be difficult to achieve, requiring decision at EU level, and may even be overturned by the European Court of Justice. Furthermore, the current rates applicable, as well as the agreed ranges, would restrict the size of the differentiation achieved. Thus, a new tax would probably have to be created, and with commitment from many if not all EU members. A consumer rebate, paid at the point of sale, may be a possibility. But ensuring that incentives were both effective and consistent among the various standards proposed, including existing organic standards, appears challenging. Consumer rebates also raise the possibility of an additional and lasting demand on public finances.

### *Conclusion*

Some tentative policy recommendations for measures to improve animal welfare in farm production can be formulated based on the combination of legal and economic analysis. Labelling of meat products that distinguishes between those that do and those that do not meet the European standard may be a logical starting point. The extent to which this is effective could be monitored. Then, at a later stage, if the results, in terms of increased market share for 'sustainable' meat, are not judged to be satisfactory, a financial instrument might be considered. Given the greater difficulties posed by a measure based on taxes or rebate, tariff differentiation would be a better place to start. In this sequential manner, a stronger case could be made that tariffs were a necessary and proportionate measure. And tariffs would, in any case, have to be accompanied by some form of labelling.

With respect to providing incentives for domestic producers to improve animal welfare standards, a regulated labelling scheme might also be the better place to begin. The expected effects in terms of improvement of animal welfare are likely to be more modest than for labelling of products that only meet EU minimum standards. In this case though, the potential for reinforcing the labelling scheme with differentiated taxes, or some other fiscal measure, seems limited. This is due less to potential conflicts with WTO rules, but more to implementation difficulties and precedents under European law. With respect to possible conflicts, note that a labelling scheme is less likely to incur a complaint and, even in such an eventuality, more likely to be upheld in a dispute settlement process as being less trade-distorting.

The proposed sequence of first labelling, with reinforcement possibly coming later by means of a financial incentive also offers more opportunities for individual member states, such as the Netherlands to undertake their own initiatives, while perhaps negotiating a common or joint approach across the EU. Individual countries, or a small group of neighbouring countries, could devise and implement labelling schemes of either type suggested above. It should be born in mind however that subsequent harmonisation of labelling initiatives across countries could be tedious. Both differentiated tariffs or taxes, on the other hand, are measures that should be implemented at European level. Import tariffs are a matter of EC responsibility. A tax measure could be implemented nationally but could then lead to unintended distortions in trade flows within the EU, and also presents difficulties in border zones where consumers can easily purchase in neighbouring countries. However, pilot initiatives with tax measures may perhaps be considered at (sub)national level, in order to investigate their possible effectiveness.

A number of issues can be identified for further analysis to inform policy makers and other stakeholders, before any decisions are taken, including:

- Quantitative analysis for specific meat products of the expected effects of the measures incorporating existing data and scenarios concerning consumer responses and the costs of meeting stricter standards both domestically and foreign;
- The possibilities of labelling of different standards, including mechanisms necessary for controlling standards in exporting countries;
- The feasibility of implementing a differentiated tariff by the customs agencies;
- Similarly, the fiscal possibilities for a differentiated tax or rebate, which is also being discussed in relation to organically-produced products.



## Samenvatting

In dit rapport wordt verslag gedaan van een onderzoek naar het verlenen van een voorkeursbehandeling voor duurzaam geproduceerde goederen bij de invoer van landbouw- en voedselproducten. Aan de orde komen zowel de juridische mogelijkheden voor dergelijk beleid binnen de huidige regelgeving onder de Wereldhandelsorganisatie (WTO), als de economische zingeving ervan. Duurzame productie wordt hier gedefinieerd als processen en productiemethoden (PPM's) die voldoen aan bepaalde criteria met betrekking tot milieubescherming, diergezondheid en dierenwelzijn. Het onderzoek is toegespitst op dierenwelzijn. Het motief voor een voorkeursbehandeling voor geïmporteerde vleesproducten die zich onderscheiden op dit aspect van dierenbescherming is om bij te dragen aan een meer duurzame productie, zowel in de EU als in landen waarmee handel wordt gedreven.

In WTO-jargon verwijst de term processen en productiemethoden (PPM's) naar de wijze waarop producten worden geproduceerd of anderszins tot stand komen. Dierenwelzijn is een voorbeeld van een zogenaamde 'niet-product-gerelateerde' PPM-kwestie, vanwege het feit dat vleesproducten niet van elkaar te onderscheiden zijn op basis van het niveau van dierbescherming tijdens de productie. Met andere woorden, niet-product-gerelateerde PPM's laten geen fysieke sporen na in het eindproduct. Handelspolitieke maatregelen die gebaseerd zijn op dergelijke criteria vallen in het algemeen buiten WTO-regels die ingaan op productstandaarden, zoals de SPS- en TBT-akkoorden, en zijn mogelijk strijdig met algemene WTO-principes.

Er is een aanzienlijke hoeveelheid regelgeving binnen de Europese Unie (EU) omtrent dierenwelzijn tijdens productie, slacht en transport. Met name voor de bescherming van productiedieren op de boerderij gaat de Europese wetgeving verder dan die in diverse andere regio's in de wereld. Dit onderzoek betreft dan ook juist de differentiatie van vleesproducten op dit aspect van dierenwelzijn. Vleesproducenten en grootverkopers/detailhandelaren hanteren in toenemende mate eigen, private standaarden voor dierenwelzijn, bovenop de wettelijke eisen. Echter, door de nadruk op prijsconcurrentie op de Nederlandse vleesmarkt, ligt het niveau van dierenbescherming van de vleesaankopen in de supermarkt dicht tegen het wettelijk minimum.

Vanuit het oogpunt van reikwijdte en internationale concurrentie ontstaat de ideale situatie om het streven naar een meer duurzame productie te verwezenlijken wanneer landen een PPM-standaard ontwikkelen en die verankeren in internationale verdragen. Vanwege het tijdsbestek van dergelijke onderhandelingen zal gezocht moeten naar tussen-tijdse oplossingen. Bij dierenwelzijn geldt dit vooral voor de bescherming van productiedieren, meer dan voor kwesties rond transport en slacht. Welke opties zijn er? Tijdens de onderhandeling van een internationale standaard kunnen landen alvast de minimumeisen opschroeven voor binnenlandse producenten. Maar het doel wordt dan deels gemist doordat vlees internationaal wordt verhandeld, en doordat een hogere welzijnsstandaard de kostprijs opdrijft. In het geval van de EU - waar de invoer 7 à 8% uitmaakt van



het binnenlands aanbod aan rund- en kippenvlees - zal het aanscherpen van binnenlandse regels simpelweg leiden tot meer invoer van minder duurzame producten.

In dit onderzoek worden drie beleidsinstrumenten onderzocht die gebaseerd zijn op de idee van voorkeursbehandeling voor meer duurzame producten: etikettering van producten (op vrijwillige of verplichte basis), een gedifferentieerde importtarieven en een gedifferentieerde consumentenheffing.

Elk van deze instrumenten kan bijdragen aan de aanscherping van PPM's op het gebied van dierenwelzijn in de EU en in de landen waarmee de EU handel drijft. Bij het analyseren van de doeltreffendheid van de voorgestelde maatregelen is het wel belangrijk om helder te zijn over het doel van het dierenwelzijnsbeleid. Ten minste twee doelstellingen zijn denkbaar. Eén, het doel van de maatregelen is om de welzijnsstandaard van productie in derde landen voor export naar de EU op het niveau van de EU te brengen, bij gelijkblijvende eisen voor EU-productie. Twee, niet alleen dient het beleid om dierenwelzijn van geïmporteerde producten op EU niveau te brengen, ook is het streven om het aanscherpen van de Europese standaard te stimuleren.

In beide gevallen kan etikettering worden ingevoerd om consumenten van meer informatie te voorzien, en om hen te prikkelen tot meer duurzame aankopen. In het eerste geval zou een etiket aangeven of producten wel of niet voldoen aan de EU standaard voor dierenwelzijn. De overheid zou die informatie moeten waarborgen, zodat we spreken van gereguleerde etikettering. Ongeacht of het gaat om een verplichte of vrijwillige informatie-overdracht voor producenten, de etikettering moet producenten in derde landen prikkelen om de EU standaard in te voeren door consumenten er bewust van te maken als importproducten afwijken van producten uit de EU.

In het tweede geval is er aanleiding voor een meer uitgebreide etikettering die erkenning geeft voor diverse gradaties van dierenwelzijn, zoals een welzijnsindex of 'stippensysteem' zoals ooit in Nederland is voorgesteld. Het doel van een dergelijk stelsel is om producenten te prikkelen om in onderlinge concurrentie de private standaard voor dierenwelzijn boven het wettelijk minimum te duwen.

Naast het voorzien van consumenten van meer informatie via het etiket kan de overheid ook gebruik maken van financiële prikkels. Invoerrechten of belastingen kunnen worden ingezet om het prijsverschil van meer duurzaam geproduceerde producten te verminderen. Meer specifiek: door differentiatie van bestaande invoerrechten (ofwel tarieven) en belastingen naar PPM-standaarden ontstaat een mogelijke compensatie voor de toename in productiekosten die gepaard gaat met het aanscherpen van eisen aan producten en processen. Differentiatie van invoerrechten betekent ofwel een lager, dus preferentieel, tarief voor vleesimporten die voldoen aan de Europese norm, of een hoger tarief voor producten niet voldoen aan de norm, of een combinatie van beide. Eenzelfde differentie is mogelijk bij belastinginstrumenten zoals accijnzen. Waar tariefdifferentiatie enkel is gericht op het verhogen van standaarden in derde landen (geval één), gaat van een gedifferentieerde consumentenbelasting een prikkel uit naar alle producenten, zowel in de EU als daarbuiten (het tweede geval). In de praktijk is een financiële prikkel moeilijk voorstelbaar zonder een vorm van gereguleerde etikettering, aangezien daarmee de consument wordt ingelicht omtrent de motieven achter het prijsbeleid.

## *WTO regels*

Aangezien de gepresenteerde maatregelen waarschijnlijk een effect zullen hebben op de wereldhandel van vleesproducten, is het van belang om te onderzoeken of deze strijdig zijn met de huidige regels onder de WTO. Zowel etikettering als belasting- en tariefdifferentiatie kan worden opgevat als een discriminerende maatregel die in zijn effect verschilt, bijvoorbeeld tussen vlees geproduceerd in de EU of elders, of tussen vlees uit verschillende productielanden buiten Europa. Het gevolg is dat de maatregelen onderwerp kunnen worden van een handelsgeschil onder de geschillenbeslechting van de WTO. Drie punten van verweer kunnen daarin worden overwogen.

- Vleesproducten die voldoen aan hogere standaarden en andere vleesproducten zijn geen 'like products', zijn derhalve niet concurrerend, zodat maatregelen mogen verschillen over deze productgroepen. WTO-panels beoordelen traditioneel of producten 'like' zijn aan de hand van criteria zoals de eigenschappen en gebruik van het product, consumentenvoorkeuren en de tariefclassificatie;
- De maatregelen zijn toegestaan onder het SPS-akkoord en het TBT-akkoord van de WTO. Onder het SPS akkoord kunnen versturende maatregelen geoorloofd zijn als deze bijdragen aan het beschermen van diergezondheid, plantgezondheid en voedselveiligheid. Onder het TBT-akkoord is het nodig om te verantwoorden dat de voorgestelde maatregel een doeltreffend en weinig handelsversturend instrument is;
- De maatregelen volgen uit de publieke moraal (maatschappelijk gedragen ethische opvattingen) en/of de diergezondheid. Op grond daarvan kan een beroep worden gedaan op GATT Artikel XX, dat onder deze voorwaarden vrijwaring kan geven voor maatregelen die strijdig zijn met de algemene beginsels van het General Agreement on Tariffs and Trade (GATT).

De kracht van deze argumenten is onderzocht op basis van een gedetailleerde analyse van de WTO-akkoorden en van uitspraken in relevante handelsgeschillen. Het eerste verweer heeft weinig kans van slagen - het is waarschijnlijk dat vleesproducten die voldoen aan verschillende standaarden op het vlak van dierenwelzijn als gelijke producten worden beschouwd. Het tweede verweer blijft mogelijk overeind, maar de haalbaarheid leunt op de kracht van wetenschappelijke bewijsvoering. Onder het SPS-akkoord dient men aan te tonen dat verhoogd dierenwelzijn tevens de gezondheid van dieren beschermt door een verminderd risico op ziekten. Dit is geen algemene opvatting. Daarnaast is er een verplichting onder het TBT-akkoord, om de noodzaak van maatregelen wetenschappelijk te onderbouwen. Deze opgave, die volgt uit het gebrek aan erkende internationale standaarden in dierenwelzijn, lijkt haalbaar. Het derde verweer biedt wellicht de meeste mogelijkheden, vooral bij een verwijzing naar het beschermen van een maatschappelijke norm. Wanneer het verweer onderbouwt dat dierenwelzijn in de EU een kwestie is van maatschappelijke normstelling, kan dat een stevige verdediging betekenen van handelsversturend beleid.

## *Effectiviteit*

Er is een kwalitatieve beschouwing ondernomen van het waarschijnlijke effect van de drie voorgestelde maatregelen. Enkel op basis van meer gedetailleerde analyse van consumentenvoorkeuren en kostenstructuren is een nauwkeuriger voorspelling te geven van verschuivingen in de aandelen van marktsegmenten, en daarmee van het effect op dierenwelzijn in de vleesproductie.

Het etiketteren van vlees dat voldoet aan het wettelijke EU-minimum op PPM's rond dierenwelzijn zal enig positieve effecten sorteren op dierenwelzijn 'in' de vleesexporten vanuit derde landen. Hetzelfde geldt voor een stelsel van gereguleerde etikettering met gradaties (stippensysteem). Moeilijker is in te schatten in welke mate een stippensysteem zal leiden tot beter dierenwelzijn in de EU-productie. Uit het bestaande, beperkte consumentenonderzoek blijkt relatief weinig vraag naar een gevarieerd vleesaanbod in termen van dierenwelzijn.

Twee maatregelen zijn geïntroduceerd om etiketten en standaarden te ondersteunen met financiële prikkels: gedifferentieerde tarieven en gedifferentieerde consumentenbelastingen. Het belangrijkste verschil tussen tarieven en belastingen is dat tarieven, als maatregel aan de buitengrens, enkel onderscheid maken tussen binnenlandse en buitenlandse producten, terwijl de (consumenten)belasting wordt geheven over alle producten op de binnenlandse markt.

Gedifferentieerde tarieven vormen een mogelijk instrument om producenten in derde landen te prikkelen om de wettelijke EU-standaard voor dierenwelzijn over te nemen. Het additionele effect hiervan op het aandeel van duurzaam vlees is waarschijnlijk beperkt. Wel is een toename van het marktaandeel van derde landen te verwachten. De tarieven kunnen zowel omhoog voor producten die niet voldoen aan de Europese standaard, of omlaag voor producten die wel voldoen. De belangrijkste bezwaren aan het tariefinstrument is de heronderhandeling binnen WTO over maximum (*bound*) tarieven in het geval van verhoging van het tarief, en de toegenomen concurrentie op de binnenlandse markt in het geval van een tariefverlaging.

Gedifferentieerde belastingen geven aan alle producenten, ook die in de EU, een sterke prikkel om het niveau van dierenwelzijn in PPM's te verhogen. Echter, het ontwerpen en invoeren van een dergelijk stelsel stuit op grote juridische en praktische bezwaren. Onder Europese wetgeving is de weg naar een BTW-korting op duurzaam vlees zeer moeilijk, zodat er voor het differentiatiedoel een nieuw belastinginstrument zou moeten komen, dat vele zo niet alle EU-lidstaten moeten erkennen. Een mogelijk instrument is een 'teruggave aan de kassa'. Bij het ontwerp van een nieuw stelsel lijkt het gecompliceerd om ervoor te zorgen dat voor de diverse 'variëteiten', inclusief de biologische, effectieve en consistente prikkels gelden. Daarnaast lijkt het problematisch dat een teruggave aan de kassa een beroep doet op overheidsfinanciering, een aanspraak die bij gebleken succes steeds groter wordt.

## *Conclusie*

De combinatie van de juridische en economische analyse leidt tot enkele indicatieve aanbevelingen over etikettering en financiële maatregelen in de handel, in het licht van het

verbeteren van dierenwelzijn in productiemethoden en processen (PPM's) op de boerderij. Een logisch startpunt voor beleid is een etikettering die onderscheid maakt tussen producten die wel voldoen aan de EU-standaard en producten die niet voldoen. De mate waarin het etiket effect heeft moet over een periode worden gevolgd. Als blijkt dat het resultaat - in termen van toegenomen aandeel 'duurzaam' geproduceerd vlees - onvoldoende wordt geacht, is een aanvullende financiële prikkel te overwegen. Aangezien er forse bezwaren kleven aan een belastingmaatregel, komt men dan uit op een stelsel van gedifferentieerde invoerrechten. Langs deze weg is tevens binnen de WTO een zaak op te bouwen dat tarieven een noodzakelijke en minimaal handelsversturende maatregel vormen.

Etikettering is eveneens een goede eerste stap bij het scheppen van positieve prikkels voor Europese producenten voor het aanscherpen van private standaarden op het gebied van dierenwelzijn. Daarbij dient wel sprake te zijn van een etikettering die gradaties aan geeft boven het wettelijk minimum. Echter, het effect in de markt is waarschijnlijk bescheiden. Ook zijn er, anders dan bij etiket dat een wel/niet onderscheid maakt, voornamelijk door Europese belastingafspraken, slechts zeer beperkte mogelijkheden om deze vorm van etikettering te ondersteunen via financiële prikkels.

De voorgestelde volgorde (starten met etikettering, mogelijk later ondersteund door een financiële prikkel) biedt mogelijkheden voor individuele lidstaten van de EU om het initiatief in eigen hand te houden, terwijl gemeenschappelijke initiatieven worden onderhandeld. Er staat individuele landen niet in de weg om genoemde etikettering door te voeren. De harmonisatie van etikettering, die onvermijdelijk volgt op een later tijdstip, is daarentegen een moeizame affaire. Voor de differentiatie van tarieven en belastingmaatregelen moet invoering geschieden op Europees niveau. Het mandaat voor het vaststellen van invoerrechten is gedelegeerd aan de Europese Commissie. Een nationale belastingmaatregel moet op Europees niveau worden getoetst aan mogelijk handelsversturende effecten op de intra-communautaire handel.

Voorafgaand aan de mogelijke inzet van deze instrumenten geldt de aanbeveling om op diverse punten tot een betere onderbouwing te komen:

- kwantitatieve analyse van de verwachte effecten van de maatregelen op basis van bestaande data en scenario's over consumentenrespons en het kostprijsverhogende effect van aangescherpte standaarden, zowel voor producenten in Europa en derde landen;
- de mogelijkheden voor etikettering van verschillende standaarden, inclusief de mechanismen voor toezicht op de standaarden in exporterende landen;
- de haalbaarheid van invoering van een gedifferentieerd tarief door de douaneautoriteiten;
- tevens de fiscale haalbaarheid van een gedifferentieerd tarief of belastinginstrument, ook met betrekking tot biologische producten.



# 1. Introduction

This report examines the possibility and effects of giving preferential treatment to imports of agricultural products that are 'sustainably-produced' relative to those that are deemed to be less sustainably produced. Sustainable production is defined as processes and production methods (PPMs) that meet specific standards with respect to criteria such as environmental impacts, animal health, and animal welfare.<sup>1</sup> The issues are examined in the context of animal welfare in meat products and 'preferred meat' refers thus to meat products that meet improved standards in terms of animal welfare. Animal welfare raises interesting issues for PPMs in the WTO, as will be seen, since it is not explicitly addressed in the GATT nor in the various agreements establishing the WTO, such as the TBT and SPS agreements. Nonetheless much of what is contained in this report is relevant for other products and sustainability concerns.

The motivation for giving preferential treatment to more sustainable imports versus less sustainable imports is, at the broadest level, to improve the sustainability of production methods for agricultural products both in the EU and its trading partners. For the specific issue of animal welfare in farm production, this policy goal also has a strong ethical motivation deriving from concern for reducing unnecessary suffering among farm animals. In this sense, animal welfare is a somewhat special sustainability concern, in comparison to more environmental concerns, such as the pollution of air or water resources.

For many sustainability issues, including animal welfare, the Netherlands and her EU partners have introduced, or are contemplating, improved standards for PPMs, generally in response to growing public concern. In such a case, the less sustainable production is displaced to the foreign producer. Thus, the policy goal of improving the sustainability of production is only partly met and domestic producers suffer stronger negative consequences.

The ideal situation is that countries can agree on common standards and institutionalize these in the form of international agreements. But such a process of negotiating an international treaty can take a very long time, and the question is whether other options are available in the interim. One option may be to set minimum standards with which imports must also comply. This is, for example, the case with food safety standards, which are regulated by the SPS Agreement. But in general the prohibition of imports on the basis of PPM standards that are motivated by sustainability concerns raises difficulties with a number of WTO principles and agreements. The scope for such standards is gradually being defined through jurisprudence, as cases are considered by the WTO's dispute settlement bodies.

Aside from minimum standards, WTO disputes have highlighted the potential of other measures to promote more sustainable PPMs in foreign exporting countries. In par-

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<sup>1</sup> An additional issue under a broad interpretation of 'sustainability' could include labour standards in production.

ticular, the provision of information on PPMs to consumers is generally considered as less trade-distorting. Financial instruments, in the form of tariffs differentiated according to PPM have been proposed. This also raises the possibility of internal taxes or subsidies that are so differentiated and imply to both domestic products and imports.

Three specific forms of preferential treatment are considered here: labelling of products (either voluntary or compulsory), differentiated import tariffs and differentiated consumer taxes. The possibility to levy differential tariffs on imports of food products, or differential taxes on the internal market, in the EU due to unsustainable production methods is included in the reaction of Cabinet to the advice of the SER (Social and Economic Council of the Netherlands) regarding reform of the CAP.

This introductory section concludes below with a brief overview of the global poultry market, the meat product market segment where imports from non-EU countries have risen most. Import penetration, i.e. the share of (third country) imports into the total EU supply, for poultry meat expanded from 2% in 1990 to 8% in 2004. Compare this with beef, for longer a major import product into the EU, for which import penetration grew by a relatively modest 40%, up to 7%. In the second section, the basic issues concerning PPMs are described, also in relation to the specific issue of animal welfare in farm production. That section also identifies the possible measures that could be contemplated. The third section consists of an expert legal opinion on the likely admissibility of such measures within the context of the WTO and a potential dispute settlement process. The fourth section reviews the likely effects of the various measures as well potential complications in implementation. The results are synthesised in the concluding section which indicates possible directions for further analysis.

## **1.1 An overview of the global poultry market**

### *Specialisation pattern*

The global poultry meat market has been expanding over the years. Poultry is increasingly preferred in many regions as a cheap source of animal protein, which unlike poultry or beef is accepted for consumption by most of the major religions in the world. Table 1.1 provides an overview of global poultry meat trade in 2003. The global production centres for poultry meat are Brazil, the United States, the EU, China and Thailand. Brazil and the US are major export countries. Poultry meat production in the Netherlands competes with producers within the EU (France) and abroad (mainly Brazil because US poultry is banned from EU markets), mainly on markets in Germany and the United Kingdom.

### *Costs, consumer preferences and animal disease: the driving forces of global meat trade*

Market developments and the outbreak of avian influenza in Asia affected both the make-up and flows of trade in poultry products. Some factors exert a longer influence, as concluded by US researchers in a recent study (Dyck and Nelson, 2003). First, natural resources, the costs of feed and labour are the most important determinants of the competitiveness of livestock and meat processing sectors. Second, international trade can arise when the preferences of consumers in the domestic market differ from foreign purchasers. Third, the share of a land in international trade is related to its status with respect to animal

diseases, in particular Newcastle disease and Avian Influenza. Table 2.1 summarises the drivers of global meat trade

*Table 1.1 Global poultry meat trade, 2003 (USD mln)*

| Exporting regions | Importing regions |              |        |       |               |        |         | Total  |
|-------------------|-------------------|--------------|--------|-------|---------------|--------|---------|--------|
|                   | EU15              | Other Europe | Asia   | NAFTA | Latin America | Africa | Oceania |        |
| EU15              | 4457.3            | 347.5        | 234.9  | 2.0   | 6.8           | 137.9  | 0.7     | 5187.2 |
| Other Europe      | 610.1             | 174.1        | 37.3   | 0.0   | 0.0           | 0.2    | 0.5     | 822.2  |
| Asia              | 439.8             | 62.2         | 1500.8 | 9.0   | 1.8           | 12.0   | 0.6     | 2026.1 |
| NAFTA             | 30.6              | 605.8        | 459.1  | 601.0 | 125.9         | 30.2   | 2.1     | 1854.7 |
| Latin America     | 663.7             | 237.3        | 798.7  | 17.8  | 33.2          | 56.6   | 0.0     | 1807.2 |
| Africa            | 0.7               | 0.0          | 1.5    | 0.0   | 0.2           | 7.2    | 0.0     | 9.5    |
| Oceania           | 0.0               | 0.2          | 5.7    | 0.0   | 0.0           | 3.7    | 4.0     | 13.6   |
| Total             | 6202.2            | 1427.2       | 3037.9 | 629.8 | 167.8         | 247.7  | 7.9     |        |

Data includes reporting countries only, which cover 96.9% of global trade. Countries excluded are India (Asia), and Argentina (Latin America).

Source: PCTAS, ITC.

### *Market differentiation*

Much of the global trade in poultry meat is explained by variation in consumer preferences across the globe. While consumers in the US, and the EU largely favour breast cuts, consumers in Asia prefer the meat on legs and wings. Producers export the cuts to markets where they get the best price. The EU provides an example of the way this trade works. All breast cuts from EU slaughters are sold on EU markets while the meat of legs and wings is exported to Russia. Imports from Brazil and Thailand satisfy the excess demand for breast cuts in the EU. Similarly, the US poultry industry supplies boneless chicken breasts to the home market, where consumers pay a relatively high price. The other parts of the carcass are exported to foreign markets where a higher price can be fetched. This explains why meat-producing countries both import and export, and why more than 90% of the trade in poultry products takes place in pieces and not whole carcasses.

In trade, the distinction is often made between white meat, i.e. the meat of breast and wing, and dark meat, i.e. drumsticks and thighs (Fuller, 2003). A recent study has, confusingly, classified white meat as high-value meat, and dark meat as low-value meat, thereby contradicting the economic fact that the prices for these products are regional (Peterson and Orden, 2004). On another level, trade differentiates between 'fresh meat' and 'processed meat' or between 'fresh' and 'frozen'. The distinction between the two is blurred. In order to keep meat fresh during chilled transport, often the meat is prepared in some way (e.g. by adding salt or water). In addition, there is a product referred to as mechanically deboned meat (MDM), which is meat scraped from the carcass of a slaughtered broiler. For customs, the product classification is relevant for the determination of the import duty. In general, the further the stage of processing of the product the higher is the applicable tariff.



*The position of the Netherlands in global meat markets*

Poultry producers in the Netherlands suffer from a deteriorating position on the global markets for meat. Between 1985 and 2003 the share in global production was halved to 0.6%, the share in EU production came down from 7.1% to 5.7%. The loss in domestic production was compensated by rising imports, most from Brazil and Thailand. Decades of advantageous feed costs, scale enlargement, and quality investments have contributed to the rise of the sector that generates 4 to 5 billion euro in value-added and provides 100.000 man-years of employment. In recent years, investments required for compliance with regulations addressing the spatial, environmental and animal welfare impact of production have increased the unit costs of production relative to competing producers in the EU and abroad. It is expected that domestic supply will contract by another 10 to 30% in the next couple of years.

*Table 1.2 Drivers and veterinary bans in global poultry trade*

| Exporter | Quality | Importer       |            |         |       |
|----------|---------|----------------|------------|---------|-------|
|          |         | EU25           | US         | Brazil  | China |
| EU25     | White   |                |            |         |       |
|          | Dark    |                |            |         | Legs  |
| US       | White   | SPS Ban        |            | SPS Ban |       |
|          | Dark    |                |            |         | Legs  |
| Brazil   | White   | Breast cuts    | SPS Ban a) |         |       |
|          | Dark    |                |            |         |       |
| China    | White   | SPS Ban        | SPS Ban    | SPS Ban |       |
|          | Dark    |                |            |         |       |
| Thailand | White   | Breast cuts b) |            |         |       |
|          | Dark    |                |            |         |       |

Empty cells indicate that there no substantial trade relation. Dark cells indicate that trade is barred by the importing country. See text for an explanation on meat quality. a) The US ban on Brazil poultry meat imports is likely to be lifted in the short term; b) The EU accepts only cooked poultry meat from Thailand in the aftermath of the Avian Influenza outbreak in 2003-04.

Source: based on Peterson and Orden (2004).

## 2. The PPM Issue

This section describes the context for a policy that differentiates between meat products in the EU. We explore first the issue of processes and production method standards (PPMs) from an economic perspective. For that purpose, we briefly describe animal welfare policies that apply to EU producers, as well as the animal welfare requirements on meat imports from third countries. The section concludes with a summary of the options with respect to measures for promoting improved animal welfare. The compatibility of these options with WTO rules is then analysed in the next section.

### 2.1 Why PPMs are controversial

There is an increasing reliance on process-based, as opposed to product-based, regulation and standards in global trade (WTO, 2004b; World Bank, 2004; OECD, 2003; Farina and Reardon, 2000). In the trade of agricultural and food products, an array of requirements on processes and production methods is governing the quality and continuity of supply. Companies apply process requirements to their suppliers to differentiate the product market, and as backbones to vertical integration efforts (Reardon et al., 2001). Examples are the codes for practices set by EUREP, a group of leading European retailers, or the fair-trade label. To governments in importing countries, regulations on production processes are instrumental in making agrifood production and trade more 'sustainable'. Examples include mandatory codes concerning hygiene conduct in post-harvest activities, or voluntary commitments to preventing the by-catch of dolphins and turtles in deep-ocean fishing.

The WTO in its various agreements regulates trade in products (GATT and GATT-implementing agreements), trade in services (GATS), and trade-related aspects of intellectual property rights (TRIPs). Production of goods (and services) does not as a rule come within the scope of the WTO. A WTO Member is thus perfectly free to regulate production of goods and services as it sees fit. However, trade (import, export, domestic) in goods comes within the scope of the WTO and when regulating such trade a WTO Member is bound to comply with a number of WTO rules. Where a WTO Member takes trade measures relating to products in function of production methods and processes and introduces differential treatment based on such production methods and processes, the question arises whether, how and to what extent WTO rules come into play and impose constraints on WTO Members in this respect.

It has been suggested that there is a general bias in WTO rules towards products as opposed to ways of producing goods, or PPMs (WTO, 2004). Two other WTO agreements are relevant here. The term 'processes and production methods' appear in the WTO Agreement on Sanitary and Phyto-sanitary Measures (SPS; Annex A, 1), which addresses the measures that governments impose in order to ensure that imports of agricultural and food products do not pose unacceptable health hazards to consumers, nor to the stock of animals

and plants. The WTO Agreement on Technical Barriers to Trade (TBT) covers the technical regulations and standards that relate to the safety of use of non-consumable products, and to the transfer of information on both non-consumables and consumables. The TBT Agreement defines 'technical regulation' as a '[d]ocument which lays down product characteristics or their related processes and production methods' (Annex 1). But these agreements do not further define the concept of PPMs.

An OECD (1997) report describes PPMs as the way in which products or services are manufactured, produced and/or processed or the way in which natural resources are extracted or harvested. The OECD summarises two scenarios in which PPMs can have a negative impact on the environment or sustainability concerns. A process or a production method can affect the characteristics of a product so that the product itself may have an impact when it is consumed or used ('product-related' PPMs; example: packaging material must be degradable in the environment). Alternatively, the process or the production method can have a social or environmental impact during the production, harvesting or extraction stage that does not have a discernible impact on the product or service ('non-product related' PPMs).<sup>1</sup>

From an economic perspective, the controversy over non-product related PPMs can be partly explained through the concept of externalities, as in the report by the OECD (1997, pp. 7-22).

'When the production, consumption or disposal of goods creates damage to the environment that is not incorporated into the cost, there is an 'external diseconomy' or 'externality'. When this externality spills over to other countries, it becomes a regional or global externality.'

The key to these 'negative' externalities is that (1) there are losses with consumers or producers that (2) are not accounted for. What type of losses? These are more than just tangible costs such as productivity losses, and cost increases; in addition these include the degradation of environmental assets (climate and biodiversity) and ethical assets (trust, well-being, etc.).

*Consumption externalities*, which are the undesirable effects on producers and consumers that occur at the stages of marketing, use and disposal of a product, arise from product-related PPMs and are easy to manage relative to production externalities. The worldwide prohibition of the use of CFC chemicals as propellant in airconditioning systems and spray cans is one example. In food trade, take the case of the ban in the EU on the use of chloramphenicol as a veterinary drug in shrimp aquaculture, in order to protect EU consumers from increased cancer risk. The ban affects shrimp producers in EU, Asia and elsewhere, and prevents that risk from any of these regions spills into the EU. (A possible product standard on this issue would specify that no traces of this antibiotic medicine in shrimps are allowed). Consumption externalities are, by definition, connected to products and their quality or safety. They cross national boundaries as easily as tradable products do. Table 2.1 classifies these PPM criteria as type-A.

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<sup>1</sup> The legal literature makes the same distinction between non-product-related PPMs and product-related PPMs, where non-product-related PPMs do not affect the physical characteristics of the final product See e.g. Appleton (1997, pp. 10-11), Daniel (2004, p. 279), Gaines (2002; L396-399), Nielsen (2005).

In case of *production externalities*, the environmental effects addressed by PPMs manifest themselves during the production activities. They often are imposed as measures:

'that restrict input use or requirements that certain technologies be adopted...at the time of cultivation, raising and slaughtering of animals, exploitation of natural resources, extraction of raw materials and production or manufacturing of goods.'  
(OECD, 1997, pp. 11)

Typically these measures do not affect product characteristics and they are thus non-product related PPM requirements. Such measures specify, for example:

- How to control the environmental pollution effects of production, such as air, water or soil degradation - possible measures are emission controls per producer unit, and technology requirements;
- The methods to be used to produce goods or the methods of resource management to meet certain objectives - examples include forest conservation; methods for catching fish or conserving certain species; provisions connected with animal welfare related to raising or slaughtering.

*Table 2.1 Classification of requirements on process and production method (PPM)*

|  | Category of PPM  |  |   |
|--|--|--|---|
|  | A  | B  | C   |
| Externality                            | Consumption externality  | Production externality   |   |
| PPM requirement                        | Product-related  | Non-product related  |   |
| Relevant WTO rule                      | GATT article XX<br>TBT agreement<br>SPS agreement  | GATT article XX;<br>Outside the scope of both TBT and SPS agreement                                      |   |
| Potential impact                       | Imported products bear food safety risk, hazards to animal/plant health or environmental degradation | Production/extraction causes environmental harm (pollution, biodiversity) at home and in other countries | Production activities have negative impact on home environment only |
| Geographical scope of undesired effect | National (but traded across boundaries)  | Cross-boundary (regional, global)  | National  |

Source: OECD (1997), adjusted.

Generally, non-product related PPMs touch on regional or global spillovers of the production externalities. These are PPMs type B in table 2.1. The measures seek to provide incentives for the internalisation of these cross-border externalities in negotiations. Examples of tangible losses to third parties are often of an environmental nature such as in the case of climate change or pollution of air or water resources. However, one can also think of less tangible losses that relate directly to consumer well-being, e.g. the dislike of child labour practices. Problems in trade arise when countries impose measures that aim to address production externalities in another country that is the country of origin of imported products, and when cross-boundary production externalities are lacking. Specifically, the mix is controversial when such PPM measures 'relate to moral values, ethical or cultural

preferences or environmental choices which lack scientific basis' (OECD, 1997, p. 19). There is no production externality outside the country where production takes on export destination countries, which justifies measures imposed by the latter that address the way of producing in the exporting country. This is PPM type-C in table 2.1.

Many contentious (possibly trade-distorting) issues related to PPMs are dealt with rather well under current rules: maximum residue levels for pesticides or veterinary medicines; labelling of nutritional content; quarantine measures to defend against invasive species; hygiene codes in food handling; even the traceability of the origin of inputs into production. The WTO has proven to be an effective platform to negotiate trade-distorting measures that aim to protect the health of consumers and the agricultural system. But these successes are essentially all product-related PPMs.

Controversy has arisen though when dealing with non-product related PPMs. This became a prominent issue in relation to eco-labelling, the voluntary labelling schemes that inform consumers about environmentally friendly products (for a summary of issues, see WTO, 2004b). The main concern is that such schemes could have a discriminatory impact against foreign products in the market, because foreign producers have unequal access to particular labelling schemes, or because eco-labels tend to have a domestic bias as they rely on domestic priorities.

The issue of non-product related PPMs was at the core of the WTO dispute cases US - Shrimps<sup>1</sup> (on the protection of sea turtles, against India, Malaysia, Pakistan and Thailand), and US - Tuna<sup>2</sup> (on the protection of dolphins, against Mexico first, and then European Community). In such cases, a WTO Member has instituted measures against a product on account of its production method as such considered harmful and where this production method does not affect the intrinsic quality of the product. One of the implications is that, in so doing, that WTO Member imposes indirectly its own policy on a production process in other WTO Members by forcing them to follow that production process if they want to export to that WTO Member. Disputes arise, for example, because the affected country argues that under Article III.4 of the GATT, 'like' products should be subject to equal treatment (as will be discussed in more detail in section 3). In WTO dispute settlement proceedings, non-product related PPMs have so far been dealt with under Article XX GATT, which offers grounds for exceptions to the GATT principles.<sup>3</sup> One of the reasons put forward for considering such measures as benefitting from the exception of Article XX was that there were international agreements that protect the interests affected negatively by the production process and the importing WTO Member's measure overruled these agreements. The treatment of PPMs in WTO dispute settlement proceedings has thus given rise to a lively debate in the literature.<sup>4</sup>

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<sup>1</sup> US - Import of Certain Shrimps and Shrimp Products, (WTO, 1998b).

<sup>2</sup> US - Restriction on Imports of Tuna, (GATT, 1991).

<sup>3</sup> US - Tuna, (GATT, 1991); US - Shrimps (WTO, 1998b); EC - Measures concerning Meat and Meat Products (WTO, 1998a) deals with a product-related PPM, as it prohibits the sale and the importation of beef which itself, because of the synthetic hormones it contains, is considered to be dangerous for human health.

<sup>4</sup> See Daniel, (2004, pp. 278-83), Reagan and Howse (2000), Weirs (2002, pp. 362-364), Gaines, (2002), Charnovitz (2002).

## 2.2 Non-product related PPM standards in EU trade: the case of animal welfare

The remainder of the section examines what the options are to impose animal welfare standards on EU imports as a case of a non-product related PPM standard. Animal welfare standards are a type-B measure that aim to internalise into the production some of the social costs related to the raising and slaughtering of livestock. It is assumed that the costs are born primarily by consumers across the border, on the grounds that governments in the meat producing country would maintain acceptable domestic animal welfare standards if there was much demand for such a code.

This sub-section reviews the standards concerning the welfare of animals that apply to meat products in the EU and the extent to which these differ from requirements for meat producers in other countries exporting to the EU.

### *Animal welfare in the EU*

EU legislation on animal welfare goes back to a 1974 Directive on the stunning of animals before slaughter. A Convention then introduced the 'five freedoms' that still convey the welfare entitlements of an animal (see box below). Since then, the protection of animals kept for farming purposes, and the conditions at slaughter and transport have been subject to an increasing body of legislation. By the late 1980s, specific legislation was introduced on the protection of pigs, calves and laying hens on farms, in response to concerns over the welfare of animals in the intensive production systems. This was updated in 1998 with Directive 98/58/EC concerning the protection of animals kept for farming purposes. Recent extensions of the animal welfare policy have focused largely on the conditions of animals during transport, culminating in the Council Regulation No 1/2005 of 22 December 2004, on the protection of animals during transport.

### *Animal welfare requirements on imports of animal products into the EU*

Animal welfare is given more legislative concern in the EU than many other regions, and some of these regions export meat products to the EU. Because of this, the European Commission has made animal protection an issue in international trade discussions. A communiqué of November 2002 describes this position (European Commission, 2002). The Commission does, however, acknowledge that the differences in animal welfare legislation among countries may poorly reflect the variation in the conditions of production animals, as compliance is often lacking, including in the EU (European Commission, 2002:7).

Animal welfare standards in farm production are generally taken to be higher in the EU than in meat producing countries exporting to the EU, particularly those in developing countries. For example the Dutch Product Boards for Livestock, Meat and Eggs (PVE)<sup>1</sup> have suggested that Dutch and other EC producers of poultry meat pay more attention to animal welfare than producers exporting countries such as Brazil or Thailand (PVE, 2004). But there is little information to assess the extent to which these PPMs do differ. Inspection reports of the EC's Food and Veterinary Office (FVO) do not contain the relevant information. With respect to animal welfare, such inspections examine primarily slaughter

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<sup>1</sup> Productschappen Vee, Vlees en Eieren (<http://www.pve.nl>).

methods and do not pay attention to other dimensions of animal welfare for which minimum standards apply in the EU.

Animal welfare policies in the EU are based on Directives from the European Community. Each member state implements the obligations therein in rules and regulations. In the Netherlands, there is framework legislation on all animal welfare issues provided by the *Gezondheids- en welzijnswet voor dieren* (framework law on the health and welfare of animals) of 1992, complemented by various measures and rules on specific issues.

General guidance on policies for animal welfare on the farm is given by the European Convention for the Protection of Animals kept for Farming Purposes. They reflect the so-called 'Five Freedoms' as adopted by the Farm Animal Welfare Council, an advisory body to the UK Government established in 1979<sup>1</sup>:

- Freedom from hunger and thirst, by ready access to fresh water and a diet for full health and vigour,
- Freedom from discomfort, by providing an appropriate environment with shelter and a comfortable resting area,
- Freedom from pain, injury and disease, by preventing or rapid diagnosis and treatment,
- Freedom to express normal behaviour, by providing adequate space and facilities, and company of the animal's own kind,
- Freedom from fear and distress, by avoiding conditions and treatment which avoid mental suffering.

#### *Animal welfare at slaughter and transport*

There is EU legislation in place that aims to protect animals at the time of transport and killing (Directive 93/119/EC). The FVO monitors the implementation of these rules in a series of missions. Between May 2003 and June 2004, 18 inspection missions were carried out in 16 member states and accession countries. Out of these, 11 addressed animal welfare during transport and slaughter; 7 inspections were done on farm holdings and transport of laying hens.

What aspects of animal welfare did the 11 general inspections address? We rely for our answer on the inspection in November 2003 in the Netherlands, which monitored the following 6 features:

- Fitness of an animal for transport;
- Vehicle requirements such as minimum deck height, access to water, and space density;
- Living conditions in the assembly centres where animals are collected before transport to a slaughterhouse inside and outside the Netherlands;
- Handling of animals during unloading and in the slaughterhouse;
- Monitoring of route plans in terms of acceptable journey times and the like;
- The features of stunning equipment in the slaughterhouses.

The inspection followed up on a similar visit to the Netherlands in 2002, the recommendations of which had been satisfactorily. While we observed 18 inspections on animal welfare in the EU25 countries between May 2003 and June 2004, there were none in non-EU countries. However, some inspections in those countries that covered food safety or animal health issues made the incidental reference to stunning equipment in slaughterhouses.

#### *Box 2.1 Animal welfare on the farm - the 'Five Freedoms'*

For a proper view on the PPM standards that apply to food imports from third countries one could examine the conditions and requirements placed on food companies that are

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<sup>1</sup> Source: [http://europa.eu.int/comm/food/animal/welfare/farm/legislation\\_en.htm](http://europa.eu.int/comm/food/animal/welfare/farm/legislation_en.htm), and <http://www.fawc.org.uk/freedoms.htm> (7 February 2005).

allowed to export food and feed products into the EU. At present, these companies are selected under a certification scheme that is monitored by local veterinary authorities. On the website of the EC Directorate-General for Health and Consumer Protection (DG SANCO)<sup>1</sup>, it is not possible to verify these conditions. In addition, the web pages of FVO<sup>2</sup> do not report on the monitoring of the certification scheme set up by the veterinary authorities in the exporting countries. Again though, these requirements relate primarily to animal health and requirements related to the slaughtering process, and thus do not encompass on-farm aspects of animal welfare.

#### *Private, voluntary standards on animal welfare in EU retail*

In addition to the regulatory process standards on animal protection, there is an array of private standards in the retail of animal products in the EU. Recent research under the DG Research's 6<sup>th</sup> Framework Program (Welfare Quality) has examined the attention for animal protection in EU supermarkets. The conclusion of the research, summarised in Ingenbleek et al. (2004), is that supermarkets are mostly involved in price competition over meat products; only some players compete specifically on quality traits, among which animal protection is included. By implication, animal welfare in most of the animal products supplied in EU supermarkets is on the minimum, regulatory level (as far as products of EU origin are concerned). The most appealing examples of private animal welfare standards in European retail are found in supermarkets in the United Kingdom and Switzerland. Retail of animal products in the Netherlands is dominated by price competition. There are minor differences between supermarket segments of the meat market.

#### *Animal welfare in trade negotiations*

The EU pursues increased attention for consumer concerns in imports from third countries via various paths. With respect to animal welfare, EU countries are among the driving partners in discussions on animal protection, at a veterinary level, within the World Organization for Animal Health (OIE), which has a working group on animal welfare. The OIE is important because it has been accepted under WTO agreement as the body that sets the standard on veterinary issues in global trade. Currently, the WTO has not explicitly recognized animal welfare as a legitimate concern, i.e. a cause for impeding trade. The European Commission has placed the issue on the agenda for negotiations under the Doha Round (see European Commission, 2000; WTO, 2000a) but there has been very little discussion recently.

#### *Global standards on animal welfare*

WTO treatment of animal welfare would change when the World Organisation for Animal Health (OIE) were to determine that protection of the quality of animal life contributes to animal health, and provides standards of some kind. To date, no such references have been made. There is, however, some progress on the matter as the 167 member countries of OIE agreed in 2004 to explore animal welfare issues. The 2005 annual meeting will discuss draft guidelines on three issues (OIE, 2004):

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<sup>1</sup> [http://europa.eu.int/comm/dgs/health\\_consumer/index\\_en.htm](http://europa.eu.int/comm/dgs/health_consumer/index_en.htm).

<sup>2</sup> [http://europa.eu.int/comm/food/fvo/index\\_en.htm](http://europa.eu.int/comm/food/fvo/index_en.htm).



- Slaughter for human consumption;
- Protection of animals during transport over sea and over land;
- Killing of animals for disease control purposes.

If agreed by the meeting, 'global' guidelines could become operational in 2006, and have immediate effect under WTO law. However, the OIE members can be expected to disagree. The more complex issues of livestock housing and management are next on the priority list. It can safely be concluded that OIE will not provide comprehensive global standards on animal welfare in the foreseeable future i.e. the next few years.

Bilateral negotiations with the major meat exporting countries to the EU have delivered little in terms of rules for animal protection. The veterinary agreements with the United States in 1999 and Canada in 1998 made no reference to issues of animal protection. Some agreements on stunning practices were made with the veterinary authorities of New Zealand in 1997, and of Chile in 2002, although the latter merely intentional. Currently, the Commission seeks to include animal welfare into the association agreement with MERCOSUR countries (Argentina, Brazil, Chile, Paraguay and Uruguay).

### **2.3 Policy options to improve PPMs**

What are the specific policy measures that can be contemplated for increasing PPMs related to animal welfare in the EU and its exporting partners? In this section, the possibilities are reviewed with the aim of identifying those that appear, at first glance, to be most feasible. This requires identifying options or scenarios with respect to general Dutch or EU policy goals. In the subsequent sections, this feasibility is examined in more depth with respect to their compatibility with WTO rules as well as their effectiveness.

The current EU legislation concerning animal welfare standards in PPMs has been referred to above. In addition to the legislated EU minimum standard, there are higher standards required for certified organic meat products, also prescribed by EU regulations. Furthermore, there appear to be a growing number of private initiatives to market fresh meat products with both higher product quality and better animal welfare standards. Then there are standards in other countries. In general, legally required standards in developing countries may be lower or nonexistent.

This current situation is presented in the left hand side of Figure 2.1. The vertical line represents a range of lower to higher standards of animal welfare in PPMs of meat products. This simplifies the differences in standards by ignoring the fact that animal welfare standards consist of many different elements. (For example, standards concerning the slaughtering of farm animals in other exporting countries may be comparable with those in the EU and embodied in EU import regulations which do not though cover other aspects of animal welfare, as seen above.) The legislated standards are placed along the line without attention given to relative distances at this point. Individual producers (and their supply chain partners) are distributed along the line. In other words, not all European producers are only complying with the minimum EU standard (which also varies in practice in its implementation from one member state to another); some produce at a higher standard.

Producers in developing countries also vary in the standard they actually achieve, although little has been documented about this variation.

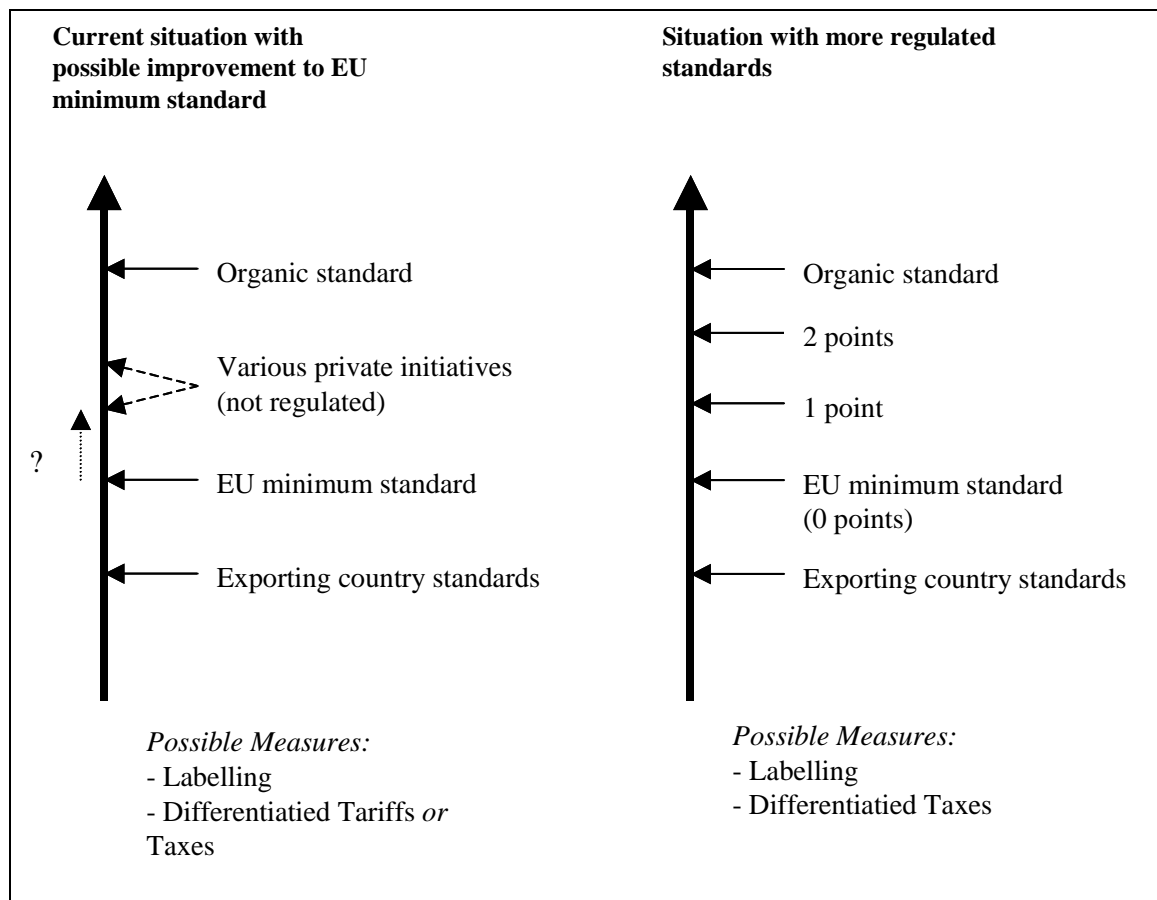


Figure 2.1 Options with respect to improving PPM standards

From the perspective of public policy, the goal is to move the current standards practiced in PPMs up the line, for both domestic and foreign producers. One option is to raise minimum standards, but as mentioned in the introduction, this will primarily, if not exclusively, affect EU producers and not those in developing countries. Another option is to promote either the voluntary or mandatory use of labelling, to provide consumers with more information concerning the PPMs. Consumers could then make better informed choices with respect to their concerns over animal welfare and other initiatives can focus on increasing this concern (for example, through awareness-raising campaigns). The current situation consists of voluntary labelling of two types. For the organic PPM standard, producers and wholesale sellers can choose to label their product but the process is not entirely voluntary or without government influence. The standards for organic production are set by EC regulations, although producers and/or their supply chain partners are responsible for organizing a credible verification and certification process. The second type of voluntary labelling concerns the private initiatives referred to above, where not only label-

ling is voluntary but also the producers and/or supply chain partners concerned also determine the standard.<sup>1</sup>

Possible policy options with respect to labelling are to regulate the labelling of PPMs in meat products meeting the minimum standard in the EU. This can be done in different ways. Either an officially-approved label could be made available for such products or a separate label could be made available for products not meeting the standard; or both labels could be made available. The first is a form of 'positive' labelling and the second, of 'negative' labelling. On top of regulating either positive or negative labelling schemes (the case with organic standards), such labelling could be made mandatory. For example, all products not complying with the EU minimum standard could be required to bear the 'negative' label. Or (different) labels could be required for all products, including those meeting the EU standard.

Regulating and possibly requiring the labelling of PPMs in meat products that meet higher standards is also an option and has been proposed, for example in the form of the point system ('stippensysteem'). In this case, one or more higher standards would be set by regulation or legislation and then labelling could be either voluntary or mandatory. Even if the decision to label is left to producers, the form of the labelling is typically determined by the government, to ensure transparent and consistent information for consumers. It is probably reasonable to expect that, if labelling is voluntary, producers will choose to label at the standard they have achieved, in order to differentiate their product from those of an inferior standard. Then all meat products would be labelled, with the probable exception of those in the lowest PPM standard, in this case, those (foreign products) not complying with the EU standard. Yet, at the same time, it would be more or less clear to consumers which PPM class the products fall into, meaning that making labelling mandatory may not imply many differences compared to when there is voluntary labelling for (various) mandated standards. Regulating the labelling of improved standards of PPMs is depicted on the right hand side of Figure 2.1. This example shows two improved standards consisting of one or two points on the product label.

In addition to providing more information to consumers by means of labelling, there is also the possibility of using financial mechanisms such as taxes or tariffs, to reduce the price difference for consumers. Existing or new taxes and/or tariffs could be differentiated according to PPM standard to compensate for higher production costs associated with improved standards. Thus, for an existing tax such as VAT, a reduced rate could be applied for meat products that do meet higher standards, or an increased rate for products that do not comply with higher standards (or a combination of both). In addition to VAT, other possible fiscal instruments include special excise taxes, such as those that have been imposed for environmental purposes on specific goods. A common example is a surcharge on batteries which is intended to cover part of the costs of special disposal systems. A tax rebate (effectively a subsidy) is conceivably also an option for meat products meeting higher standards. Tariff rates for imported meat products could be similarly differentiated. The rate could be reduced for products meeting the higher standard and/or increased for products not meeting such standards.

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<sup>1</sup> Voluntary labelling that is regulated is sometimes also referred to as 'supervised labelling schemes', and unregulated labelling, as 'self-imposed' by producers and processors (European Commission 2002, p. 14).

The main difference between differentiating by means of taxes as compared to tariffs is that the latter apply only to imports. Tariffs are a relevant option as long as the policy goal includes increasing standards of production in foreign producing countries, while maintaining or possibly raising the EU minimum standard. This is the situation indicated in the left-hand side of Figure 2.1. In this case, PPM standards are possibly improved within the EU, but only by means of introducing a stricter minimum standard. The financial instrument of tariffs is employed as an incentive for foreign producers to adopt the EU minimum standard. If, on the other hand, the policy goal also includes an improvement in EU PPMs, but without necessarily raising the EU minimum standard, then the financial instrument would have to be some form of differentiated tax (or subsidy). A differentiated tariff would only provide an incentive operating on imported products whereas a tax measure could apply to all products on the market. Thus, coupling financial incentives with the proposed point-labelling system would have to be done using a tax-based measure. This is the situation represented by the right-hand side of Figure 2.1. It may be possible to combine both differentiated tariffs with differentiated taxes so that higher tariffs are applied to foreign products not meeting the European standard and then tax concessions or reductions are applied to all products on the domestic market meeting even higher standards. This kind of combination would require careful attention to design to ensure that incentives were consistent between foreign and domestic producers.

In practice, differentiated taxes or tariffs would be applied in combination with some form of labelling. These financial instruments are intended to influence consumer behaviour, and would likely have much less effect if not accompanied by labelling. Producers of meat products meeting higher standards can also be expected to communicate this information to consumers.

### 3. Compatibility with WTO rules

This section examines whether the potential measures contemplated and consisting of labelling schemes, differentiated tariffs or differentiated taxes, would be consistent with WTO rules as laid down in WTO agreements and as interpreted in WTO dispute settlement proceedings.<sup>1</sup> The approach followed is one of defending the measures contemplated under WTO rules against possible challenges.

The objections likely to be raised in light of WTO rules are that 'preferred meat' and 'non-preferred meat' are 'like products'. As a result, and this concerns differential taxation of 'non-preferred meat', imported 'non-preferred meat' may, under Article III.2 GATT not be subject to internal EC taxes or other internal EC charges of any kind in excess to those applied to EC origin 'preferred meat'. As a result, and this concerns differentiated (lower) customs duties on 'preferred meat' imports, 'non-preferred meat' imported from WTO Members may under Article I.1 GATT not be subject to a higher customs duty than that applying to 'preferred meat' imported from other WTO Members. As a result, and this concerns mandatory labelling of 'non-preferred meat', imported 'non-preferred meat' must under Article III.4 GATT be accorded 'treatment no less favourable' than that accorded to 'preferred meat' of EC origin in respect of regulations affecting its sale in the EC.

This section analyses the possible defenses against potential WTO challenges to such measures. A first part of this section analyses whether and to what extent the following defenses are available:

- 'Preferred meat' products are not like other meat products and imported products are not subject to less favorable treatment (Art. III:4 GATT);
- The contemplated measures may be imposed under the WTO SPS Agreement and the WTO TBT Agreement;
- Alternatively, as the contemplated measures are necessary to protect public morals (Art. XX(a) GATT), animal health (Art. XX(b) GATT) and (conceivably) the environment, they benefit from the exception of Article XX GATT.

A second part of this section completes and qualifies the defenses in function of the different possible designs of the measures.

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<sup>1</sup> This section was written by Professor Jacques Bourgeois, partner with Akin, Gump, Strauss, Hauer & Field, Attorneys at Law, Brussels.

### 3.1 Available defenses

#### 3.1.2 'Preferred meat' is not like 'non-preferred meat' and imported meat is not treated less favourably than domestic meat

The concept of 'like products' is relevant as the contemplated measures distinguish between 'preferred meat' and 'non-preferred meat'. It is to be examined whether these measures may conflict with the MFN treatment provided in Article I:1 GATT and with the national treatment provided in Article III GATT, provisions which use the concept of 'like product'.

The following analysis focuses on the concept of 'like products' under Article III GATT to which the general MFN clause of Article I:1 refers. This concept appears also in other GATT provisions and in GATT implementing agreements where it may mean something different. Even within Article III, 'like product' for purposes of Article III:2 is different from 'like product' for purposes of Article III:4. The implications for the various measures contemplated to deal with preferred' and 'non-preferred' meat will be examined below.

It must be pointed out at the outset that the interpretation of the concept of 'like product' under Article I:1 and Article III GATT in dispute settlement proceedings is not a model of consistency. It is not a model of clarity either: in theory, panels and the Appellate Body adhere to criteria developed more than 30 years ago, but in practice, they bend these criteria to suit the purpose of curbing protectionist measures or measures perceived as such by them.<sup>1</sup> This means that conclusions on whether the measures as contemplated would withstand a challenge in a WTO dispute settlement proceeding need to be qualified.

Traditionally, in order to determine whether products are 'like' most WTO panels and Appellate Body use the criteria developed by the Report of the Working Party on Border Tax Adjustments (GATT, 1970, p. 102).

- Properties, nature and quality of the product;
- End-uses of the product;
- Consumers' tastes and habits;
- Tariff classification of the product.

On 'consumers tastes and habits', panels look at 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.<sup>2</sup>

In such analysis, the evidence relating to each of those criteria is examined separately and then all of that evidence is weighed, along with any other relevant evidence, in making an overall determination of whether the products at issue could be characterised as 'like'. This list is adhered to, but there are qualifications.

*First*, the Appellate Body indicated that:

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<sup>1</sup> This lack of clarity and consistency is criticized in the literature; see Melloni (2005, p. 156); Regan and Howse (2000, pp. 258-268); Regan (2002); and Roessler (2003).

<sup>2</sup> In US - Taxes on Automobiles (GATT 1994), the panel relied on consumers' perception, since evidence showed that American consumers viewed light trucks as passengers vehicles and, hence substitutable with passengers vehicles, although the panel assessed likeness on the basis of the aim of the regulatory measure and its protective effects on the market.

'In particular, Panels must examine those physical properties of products that are likely to influence the competitive relationship between products in the market place.'<sup>1</sup>

In other words, the extent to which products are competing is also examined.

*Second*, panels and the Appellate Body are very reluctant to look into the 'purpose and intent' behind WTO Members measures or 'the aims and effects' of such measures under Article III GATT.<sup>2</sup> There are nonetheless some cases in which panels looked more carefully at policy behind such measures.<sup>3</sup>

*Third*, Article III:1 refers expressly in relation to internal taxes to the criterion 'so as to afford protection'. It has been applied in cases involving internal taxes (Art. III:2). The issue has arisen whether it also applies in cases involving other internal measures (Art. III:4). In EC - Bananas, one of the issues related to so-called hurricane licenses, which allowed for additional imports of non-ACP bananas. The Panel had found that, as these licenses were issued to EC producers, this EC measure was applied so as to afford protection to the EC (and ACP) producers. The Appellate Body confirmed the Panel's finding that this EC measure was inconsistent with Article III.4 GATT, but held that:

'a determination whether there has been a violation of Article III:4 does not require a separate consideration whether a measure afford[s] protection to domestic production.'<sup>4</sup>

However, in EC - Asbestos, in relation to Article III:4 the Appellate Body refers to the purpose of avoiding protectionism.<sup>5</sup> In the same case, the Appellate Body stated that:

'Members may draw distinctions between products which have been found to be 'like' without, for this reason alone, according to the group of 'like' imported products 'less favorable treatment' than that accorded to the group of 'like' domestic products.'<sup>6</sup>

This rather enigmatic statement can hardly mean that, if imported and domestic products are subjected to the same rule, there would be no violation of Article III:4 GATT.

*Fourth*, while not referring to 'so as to afford protection', this criterion reappears under another guise in a number of cases: that of ensuring 'equality of competitive opportunities' i.a. in respect of measures covered by Article III:4. E.g. in US - Section 337, the panel observed that imported products should enjoy effective equality of competitive opportunities in respect of the application of laws, regulations and requirements affecting

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<sup>1</sup> Japan - Taxes on Alcoholic Beverages (WTO, 1996b, para 114).

<sup>2</sup> E.g. The Appellate Body rejected the 'aim and effect' test in Japan - Alcoholic Beverages, (WTO, 1996b, pp, 20-24); in EC - Bananas (WTO, 1997b, paras 215-216) it rejected the panel's inquiry into the purpose of the measure.

<sup>3</sup> See US - Measures Affecting Alcoholic and Malt Beverages (GATT, 1992); US - Taxes on Automobiles (GATT, 1994); Chile - Taxes on Alcoholic Beverages (WTO, 1999, paras 7.125 - 7.148); EC - Conditions for the Granting of Tariffs Preferences to Developing Countries (WTO, 2004a, para 7.200).

<sup>4</sup> EC - Bananas (WTO, 1997b, para 216).

<sup>5</sup> EC - Measures Affecting Asbestos and Asbestos-Containing Products (WTO, 2001, paras 93-96).

<sup>6</sup> EC - Measures Affecting Asbestos and Asbestos-Containing Products (WTO, 2001, para 100).

the internal sale.<sup>1</sup> In EC - Bananas, the Appellate Body upheld the panel's findings that special licenses were only allocated to operators who directly represented EC producers, and they, therefore, affected the conditions of competition for bananas from the third countries.<sup>2</sup>

*Fifth*, in EC - Asbestos<sup>3</sup>, the WTO Appellate Body reversed the panel's finding that chrysotile asbestos and PCG fibers were 'like products' within the meaning of Article III:4 of the GATT. The Appellate Body relied i.a. on the following argument:

'[T]he fibers have very different properties, in particular because Chrysotile is a known carcinogen.'<sup>4</sup>

As a result, a very heavy burden is placed on Canada, the complainant, to show that notwithstanding this, Chrysotile asbestos and PCG fibers are competing.<sup>5</sup> The Appellate Body found that this had not been established. The consequence was that, Canada not having shown that Chrysotile asbestos was 'like' PCB fibers, the French regulation banning the sale of Chrysotile fibers did not infringe Article III:4 GATT.

This case is problematic. *First*, this interpretation of Article III:4 GATT in this case is considered as quite novel. This report is the only one of two reports with a recorded concurring / dissenting opinion of a Member of the Appellate Body. The Appellate Body is not likely to apply the interpretation extensively. *Second*, the French regulation was designed to protect human health. WTO adjudicating bodies are very reluctant to strike down measures designed to protect human health, they are likely to be less reluctant when measures are designed to protect animal welfare, animal health and the environment. Rather than opening the door to the protection of such interests via Article III:4, they do so via Article XX with its burden of proof on the respondent WTO Member and with the qualifications appearing in the 'chapeau'. The 'Asbestos' interpretation could, however, conceivably be relevant where it can be demonstrated that the sort of diseases to which animals are exposed present a risk for human health.

As appears from the review of the issue of 'like product', it is unlikely that the argument based on the criterion of consumers' tastes and habits would succeed. The argument related to features of the product that matter for the consumer would be fairly easily rebutted. Even if many EU citizens care about animal welfare, those that eat the meat do not care. Even if meat eaters care about animal welfare, it is still rational for them to buy 'non-preferred' meat because the cost to animal welfare from their choice falls mostly on others. It is precisely because the consumer does not distinguish between 'preferred' and 'non-preferred' meat that governmental authorities take measures.

One would thus have to go to arguments other than those based on the traditional criteria formally adhered to by panels and the Appellate Body. Earlier on, this memorandum has concluded that EC - Asbestos does not constitute a reliable precedent.

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<sup>1</sup> US - Section 337 II of the Tariff Act of 1930 (GATT, 1989, para 5.11).

<sup>2</sup> EC - Bananas, (WTO, 1997b, para 248).

<sup>3</sup> EC - Asbestos, (WTO, 2001, para 131).

<sup>4</sup> EC - Asbestos, (WTO, 2001, para 118).

<sup>5</sup> EC - Asbestos, (WTO, 2001, para 118).



The argument that there is no competitive relationship in the market place between the alleged 'like' 'preferred' meat and 'non-preferred' meat is unlikely to convince a panel or the Appellate Body, if the measure would take the form of a financial charge of some sort imposed on 'non-preferred' meat. The counter-argument would be that the measures themselves prove that 'preferred' and 'non-preferred' meat are in competition, as they are designed to compensate for the higher cost of producing 'preferred' meat, or have that effect.

Assuming for the moment that the measures contemplated would apply equally to imported and domestic meat (i.e. EC produced 'non-preferred' meat would still be allowed), the better argument would be that the measures are origin-neutral, as opposed to origin-based.

Origin-based measures distinguish between products on the basis of their origin, origin-neutral do not. Korea - Beef concerned a dual retail system for beef, which included the obligation for department stores and supermarkets to hold a separate display and the obligation for foreign beef shops to bear a sign with the words 'specialized imported beef store'. The Panel had condemned this system on the ground that 'any regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products is incompatible with Article III'. The Appellate Body rejected that part of the reasoning of the Panel and held:

'A formal difference in treatment between imported and like domestic products is (.....) neither necessary, nor sufficient, to show a violation of Article III:4.'<sup>1</sup>

The Appellate Body nonetheless upheld the finding of inconsistency as the 'treatment accorded to imported beef, as a consequence of the dual retail system..., is less favourable than the treatment given to like domestic beef' as it 'modifies the conditions of competition in the Korean beef market to the disadvantage of the imported product'. It is not sufficient that a measure be origin-based to show a violation of Article III:4. However, it is treated with suspicion. It is not necessary that a measure be origin-based to show a violation of Article III:4. Thus, an origin-neutral measure may be in violation of Article III:4 (and for that matter of Article III:2 relating to internal taxes), when it is *de facto* discriminatory.

National rules that are on their face origin-neutral are caught by Article III:

- If they impose overall greater disadvantage on imports;<sup>2</sup>
- If the burden arising from the measure is heavier for imported products than for domestic products.<sup>3</sup>

The case-law shows that panels and the Appellate Body are fully aware of, and prepared to prohibit, indirect discrimination whatever form it takes<sup>4</sup>, verifying whether there is

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<sup>1</sup> Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef (WTO, 2000b, para 137).

<sup>2</sup> See Spain - Tariff Treatment of Unroasted Coffee (GATT, 1981); Japan - Taxes on Alcoholic Beverages (WTO, 1996b).

<sup>3</sup> Ehrling (2002) and cases cited.

<sup>4</sup> E.g. in Canada - Certain Measures Concerning Periodicals (WTO, 1997a), the Canadian regulation distinguished products not on physical characteristic but on the basis of the destination of a part of the production. The tax was considered to *de facto* afford protection to domestic products.

indirect or de facto discrimination in light of 'equal competitive relationships for all directly competitive or substitutable imported products in relation to domestic products'.<sup>1</sup>

This argument that the measures are origin-neutral could also be produced to show that the treatment of imported meat is not less favorable. In order for this argument to succeed, measures should not be de facto discriminatory. In other words they may not impose an overall greater disadvantage on imported 'non-preferred' meat or the burden arising from them may not be heavier for imported 'non-preferred' meat than for the domestic one. It is difficult to say in the abstract when the burden on imported products would be heavier. One can only suppose that, if e.g. 80% of the domestic meat production would be 'preferred' meat, while practically all imported meat would be 'non-preferred', a WTO panel would very probably consider either that the imported products are 'like' the domestic products or that the measure is de facto discriminatory.

In terms of the measures contemplated here though, it does not appear safe to assume that the measures would apply equally to imported and domestic meat. 'Non-preferred' meat is not produced according to the EU minimum standard and is therefore only produced in foreign countries. Either forms of labelling proposed would distinguish between meat products that do and do not comply with the EU minimal standards for animal welfare, and so would most likely be considered as de facto discriminatory.

In the literature it has also been argued that the purpose of regulatory measures has a role to play in the assessment of whether there is a 'less favourable treatment' for imported products. This should allow the WTO to uphold process-based measures that embody a non-protectionist purpose, even if the products made with different processes are physically like and therefore held to be 'like'.

The idea is interesting but it does not rest on any precedent. Using it would certainly meet the 'red-face' test, but it would undoubtedly be an uphill battle to make it succeed, even if one could exploit the enigmatic obiter dictum of the Appellate Body in EC - Asbestos (see above). The argument could be that imported 'non-preferred' meat is treated less favourably not because it is imported but because it is 'non-preferred'. This argument would, however, fail at any rate if the contemplated measures would affect imported meat disproportionately.

By way of conclusion: except where the contemplated measures would not affect imported meat disproportionately, the argument that 'preferred' and 'non-preferred' meat are not 'like' or that imported 'non-preferred' meat is not treated less favourably are not likely to succeed. As a result the claim that the contemplated measures are not prohibited by Article III GATT is not likely to be upheld.

### 3.1.2 The contemplated measures may be imposed under the WTO SPS Agreement or the WTO TBT Agreement

In light of the matter dealt by them, the WTO Agreement on Sanitary and Phytosanitary Measures (SPS Agreement) and the WTO Agreement on Technical Barriers to Trade (TBT

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<sup>1</sup> Chile - Taxes on Alcoholic Beverages (WTO, 1999, para 67). In the same vein, the panel in the recent case Dominican Republic - Sale of Cigarettes (WTO, 2005b) with respect to the tax stamp requirement.

Agreement) may offer a defense, provided certain conditions are met. In EC - Asbestos, the Appellate Body stated that:

'although the TBT Agreement is intended to further the objective of GATT, it does so through a specialised legal regime that applies solely to a limited class of measures. For these measures, the TBT imposed obligations on Members that seem to be different from, and additional to, the obligations imposed on Members under GATT.'<sup>1</sup>

The above reasoning applies also to SPS Agreement.

Due to the fact that these agreements are more specific than GATT, additional requirements need to be met. The relationship between the SPS and TBT agreements and GATT, in particular Article III, still needs to be fully clarified. E.g. a measure covered by the SPS or the TBT agreements may be trade restrictive. However, a showing that the measure taken is 'excessive', i.e. more restrictive on trade than is necessary to achieve the policy aim, can justify a finding the measure to be a violation of the SPS and TBT agreements.<sup>2</sup>

It is in this respect that these agreements could offer a defense, provided the contemplated measures come within the scope of either one of these agreements and the conditions to which they subject the contemplated measures are met.

To come under SPS Agreement, the aim of the contemplated measures should be the protection of animal health by preventing risk of spreading of pests and diseases. The measures must be proportionate, based on scientific assessment and refer to international standards. In the event that there are no such international standards, measures need to be scientifically justified.

The 'rule of equivalence' applies: if the exporting Member objectively demonstrates to the importing Member that its measures achieve the importing Member's appropriate level of sanitary or phytosanitary protection, the importing Member must recognise such products and grant them reasonable access to its market.

The definition of SPS measures includes processes and production methods. It is unclear whether this definition is limited to product-related PPMs, or whether it also includes non-product-related PPMs, i.e. the type of contemplated measures.

In order to be capable of being justified under the SPS Agreement one must scientifically establish that producing e.g. poultry and pork in conditions that are contrary to animal welfare is likely to lead to rapid spread of animal diseases. The higher degree of 'food-born' risk requires lesser risk assessment.<sup>3</sup>

The TBT Agreement aims to ensure that technical regulations, standards and conformity assessment procedures do not create unnecessary obstacles to trade. The definition of 'technical regulations' refers 'product characteristics and their related production methods'. The definition of 'technical regulation' for purposes of determining the scope of the TBT

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<sup>1</sup> EC-Asbestos, (WTO, 2001, para 80).

<sup>2</sup> Article 2.2 TBT, Article 2 SPS; see also Ortino, (2004; p. 434-473).

<sup>3</sup> In the Appellate Body Report on Australia - Measures Affecting the Importation of Salmon (WTO, 1998c, para 123), '(food-born risks) require only the evaluation of the potential for adverse effects on human or animal health'.

Agreement was at issue in two recent cases.<sup>1</sup> The Appellate Body emphasised the three criteria that a document must meet in order to be defined as 'technical regulation': *first*, the document must apply to an identifiable product; *second*, the document must lay down characteristics of the product; *third*, compliance with the product characteristics must be mandatory. The Appellate Body indicated that 'product characteristics' include not only features and qualities inherent to the product itself, but also related 'characteristics', such as the means of identification, the presentation and the appearance of the product.<sup>2</sup> As in the case of the SPS Agreement, it is not clear whether this wording includes non-product related PPMs as an acceptable technical regulation.

According to the TBT Agreement, a Member needs to show that measures are proportionate (no more trade-restrictive than necessary) and are equivalent to international standards. If such measures do not use international standards as a basis or if there are no international standards, these measures may become subject to negotiations. Further, in order to ensure that trade is not affected because of the differences in standards, the Agreement requires Members 'to accept as equivalent' technical regulations, even if such regulations differ from their own, provided they are satisfied that they fulfill the objectives of their own regulation.

There is not currently any international standard that could be relevant for the contemplated measures under the TBT Agreement. Nor is there a multilateral agreement aimed broadly at animal health protection and animal welfare that could be relevant for the contemplated measures under SPS Agreement.<sup>3</sup> The international agreements found deal with specific species (e.g. endangered species) or animals in specific situations (e.g. transport, protection of vertebrate animals used for experimental purposes). There are no wide-ranging international agreement dealing with production measures.

Consequently, in order to be justified the contemplated measures must be based on an assessment of the risk that they are designed to prevent, which risk assessment must be based on scientific evidence. If the risk cannot be proven, the EC may not ban imports of 'non-preferred' meat under the SPS Agreement<sup>4</sup>; the same would very probably apply under the SPS Agreement as well as under the TBT Agreement to other measures that would restrict trade of imported 'non-preferred' meat. In this respect, it is worth noting that the TBT

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<sup>1</sup> EC- Asbestos (WTO, 2001); EC - Trade Description of Sardines (WTO, 2002b).

<sup>2</sup> EC-Asbestos, (WTO, 2001, para 67).

<sup>3</sup> The WTO and the World Organization for Animal Health (OIE) signed a cooperation agreement, by an exchange letter dated 4 May 1998, formalizing cooperation as to exchange of advice, sharing of information and exchanging documents about a number of areas covered by the WTO SPS Agreement. Moreover, the OIE has been recognized, under WTO SPS Agreement, as the leading international standards-setting organization for animal health and animal diseases that are transmissible to humans.

Note, however, that, under WTO TBT Agreement Members are not required to base themselves on standards that are being discussed with the OIE. Should there, however, already be a broad consensus on a standard in such forum, it would be difficult for a WTO panel or the Appellate Body to disregard the contemplated measures based on such not yet adopted standard.

<sup>4</sup> EC-Hormones, (WTO, 1998a, para 193) ; that case related to the prohibition of imports of beef from cattle with respect to which Canada or the US did not provide a certification that none of the hormones listed by the EC had been administered. The Appellate Body found that the measure, which resulted in a higher level of sanitary protection than would be achieved by measures based on the relevant Codex Alimentarius standards, was insufficiently justified scientifically.

Agreement states that '[i]n assessing such risks... relevant elements are inter alia: available scientific and technical information...' (Art. 2.2).

By way of conclusion: the contemplated measures could probably be justified:

- Under the SPS Agreement, if it can be shown that the contemplated measures (also) aim at protecting animal health by preventing risk of pests and diseases;
- Under the TBT Agreement as a 'technical regulation' provided that:
  - In the absence of international standards or an international agreement, the contemplated measures are based on scientific assessment;
  - The contemplated measures are not more restrictive of trade than is necessary to achieve the policy aim.

### 3.1.3 As the contemplated measures are necessary to protect public morals and animal health, they benefit from the exception of Article XX GATT

Article XX GATT exempts measures that are inconsistent with a substantive obligation under GATT from the prohibition of such measures, if they can be justified under Article XX. In light of the aim pursued by the contemplated measures, the following sections of Article XX are relevant:

- Measures necessary to protect public morals (Art. XX(a) (animal welfare));
- Measures necessary to protect animal health (Art. XX (b) (animal health)).

Article XX GATT does not refer to measures designed to protect the environment. This does, however, not necessarily mean that, where such measures affect trade, they cannot benefit from the exception of Article XX. Strenuous attempts are made by the WTO 'political' (as opposed to 'adjudicative') bodies to 'pigeonhole' environmental policy concerns within the existing WTO legal framework: e.g. the WTO Committee on Trade and Environment refers to the exceptions in Article XX(b), (d) and (g) as environmental exceptions.<sup>1</sup>

The literature is not of much help: animal welfare and environment are often referred to as 'environment' without any analysis of the differences under Article XX GATT.

It should also be noted that the policy contemplated could come within the scope of more than one section of Article XX GATT and should, if need be, be justified by reference to more than one section of Article XX GATT. E.g. a measure restricting or even prohibiting the rearing of hens or swine in batteries could be justified as being in the interest of the health (possibly mental) of the animals or as a matter of public morals.

Interestingly, the WTO case-law has not led to some criteria for classifying measures under one section of Article XX GATT rather than under another. Panels and the Appellate Body limit themselves to take a position on the exceptions as they are invoked by the parties to the dispute.

#### *Protection of animal welfare (Art. XX(a) GATT)*

The concept of 'public morals' is obviously a difficult one to handle for international adjudicative bodies such as WTO panels or the WTO Appellate Body. This is particularly the

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<sup>1</sup> (WTO, 2002a, p. 3).

case in the absence of common views of public morals as expressed in international agreements. One author qualified as:

'some of the most difficult aspects of the trade-environment nexus in the WTO' 'unilateral actions affecting trade based on production methods in other Members on which no international consensus can be found, precisely because the arguments condemning foreign production methods are based on moral arguments in the importing country.'<sup>1</sup>

No conclusions can be drawn from earlier dispute settlement proceedings. Until recently, only one panel (a GATT panel) had been asked to interpret Article XX(a).<sup>2</sup> In the recent US-Gambling case,<sup>3</sup> the panel avoided the issue but the Appellate Body ruled on it. This is the first WTO case that broadly addresses exceptions relating to 'public morals'.<sup>4</sup>

It implies, that in order to rely on 'public morals' exception under Article XX, one needs to establish: first, that the measures challenged comes within the scope of Article XX (a) (the measure is 'designed' and 'necessary' to protect public morals) and second, that the measure satisfies the requirements of the 'chapeau' analysis of Article XX (i.e. is not a 'disguised restriction on international trade' or is not 'a means of arbitrary or unjustifiable discrimination').

The 'necessity' test is about whether the trade measure at issue is 'necessary' to achieve the policy goal. As it was stated in WTO case law,<sup>5</sup> whether a measure is 'necessary' should be determined through 'a process of weighing and balancing a series of factors'.<sup>6</sup> The Appellate Body characterised this process as one:

'comprehended in the determination of whether a WTO consistent alternative measure which the Member concerned could 'reasonably be expected to employ' is available, or whether a less WTO inconsistent measure is 'reasonably available'.<sup>7</sup>

The 'reasonably available' alternative measure must be a measure that would preserve for the responding Member its right to achieve its desired level of protection with respect to the objective pursued under paragraph (a) of Article XX.<sup>8</sup> Should be taken into account,

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<sup>1</sup> Wiers (2002, p. 191).

<sup>2</sup> US - Measures Affecting Alcoholic and Malt Beverages, (GATT, 1992); the panel ducked the issue. In Tuna-Dolphin, (GATT, 1991, n. 26), the representative of Australia argued that Art. XX (a) could justify measures regarding inhumane treatment of animals, but the panel did not address this issue.

<sup>3</sup> US - Measures Affecting the Cross-boarder Supply of Gambling and Betting Services, (WTO, 2005a).

<sup>4</sup> The case between the United States and Antigua concerned US provisions totally banning online gambling. Although the case fell under GATS (General Agreement of Trade in Services), both of the GATS and GATT Agreements pursue the same objectives, use similar language, therefore, in accordance with Appellate Body reasoning, the case is relevant for the 'public morals' issue considerations under GATT as well.

<sup>5</sup> See Korea - Measures on Beef (WTO, 2000b); Thailand - Restrictions on Importation of Internal Taxes on Cigarettes, (GATT, 1990).

<sup>6</sup> Korea - Measures on Beef, (WTO, 2000b, para 164).

<sup>7</sup> Korea - Measures on Beef, (WTO, 2000b, para 165).

<sup>8</sup> Korea - Measures on Beef, (WTO, 2000b, para 180); EC - Asbestos, (WTO, 2001, paras 172-174).

factors such as the trade impact of the measure, the importance of the interests protected or the contribution to the realisation of the aim pursued.<sup>1</sup>

In the US - Gambling case the Appellate Body affirmed that moral concerns such as underage gambling, fraud, compulsive gambling might justify introducing trade barriers. It upheld the US's reliance as the GATS clause paralleling Article XX GATT.

Therefore, unilateral action based on moral arguments can be taken by a Member. However it needs to be carefully scrutinized, consistently applied as to not put only imported products in a trade-disadvantaged position. According to the literature, it is probably safe to assume that animal welfare protection is an issue of public morals.<sup>2</sup> In light of the Appellate Body report in US - Gambling, one would agree: one may expect WTO panels and the Appellate Body to display considerable deference for what a Member considers as, and shows to be, a matter of public morals.

#### *Protection of animal health (Art. XX(b) GATT)*

However, as it is apparent from dispute settlement proceedings involving other sections of Article XX GATT, a WTO panel and/or the Appellate Body are likely to review closely the necessity of the measure to protect interests others than public morals referred to in those sections. Provided there is scientific evidence, showing that the production methods and processes that the contemplated measures are designed to regulate, are damaging the health of animals, Article XX(b) GATT could be successfully relied upon. This section has been invoked in US - Shrimps but not been relied upon by the Appellate Body. No adverse conclusion should be drawn from this: the Appellate Body noted that the US had invoked Article XX(b) only in the alternative to Article XX(g) and considered that it was 'not necessary to analyze the measure in terms of Article XX(b)'.<sup>3</sup>

#### *Policy to protect the environment*

In US - Shrimp, the US measures imposed on US trawlers the obligation when fishing shrimp to use a so-called Turtle Excluder Device. It prohibited also the imports of shrimp except where it was certified that shrimp had been caught by non-US trawlers equipped with such device or an equivalent device. The US relied on the Article XX(g) exception arguing that sea turtles are 'exhaustible'. As already indicated there is no 'pigeonhole' in Article XX for the protection of the environment. This has not prevented the Appellate Body in this case from considering as benefiting from the exception of Article XX(g) GATT PPMs taken by the US to protect sea turtles. It took the view that it was 'too late in the day' to suppose that Article XX(g) GATT covers only non-living resources. It also referred to the objective of sustainable development in the preamble to the WTO Agreement to interpret 'natural resources' as 'by definition, evolutionary'<sup>4</sup>, and it was also able to refer to an international agreement.

As already mentioned, we have not found any comprehensive international agreement on animal welfare standards, particularly as an environmental protection measure, that would allow to argue that the common intent of WTO Members must have been to

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<sup>1</sup> US - Gambling, (WTO, 2005a, paras 306-311).

<sup>2</sup> Nielsen (2005, p. 159f).

<sup>3</sup> US - Shrimp, (WTO, 1998b, para 146).

<sup>4</sup> US - Shrimp, (WTO, 1998b, para 131).

permit the sort of trade measures to protect the interests that the contemplated measures seek to protect. As long as WTO Members have not concluded such an agreement, it will be difficult to convince a panel and the Appellate that it should consider the contemplated measures as a measure to protect the environment for the purpose of Article XX. In accordance with the Vienna Convention<sup>1</sup> and the ICJ<sup>2</sup> international custom evidenced by general principles of law might serve as an autonomous source of international law. There are symptoms of changing overall attitude towards animal welfare awareness.<sup>3</sup> However, in order to be considered as justifying a broad reading of Article XX such awareness must be shared by a great many, if not all, WTO Members.

In the event that it is confirmed that there are no such international agreements, it is recommended that, before enacting measures regulating trade, differentiating between 'preferred' and 'non-preferred' meat products, consultations be held with WTO Members that are exporting 'non-preferred' meat products to the EC. Such consultations were treated by the Appellate Body in *US-Shrimps* as an important element of the acceptability of the US measures under Article XX. The EC must accept anyway to enter into consultations under the SPS and TBT Agreements.

### *The 'chapeau' of Article XX GATT*

As already indicated the recourse to the exception of Article XX is subject to the conditions set out in the 'chapeau' of that Article: the measures are not applied in a manner which would constitute 'a means of arbitrary or unjustifiable discrimination' or 'a disguised restriction on international trade'.

In one of its first cases the Appellate Body made clear that the 'chapeau' analysis is the final test to ensure that the exceptions of Article XX are not abused and that it is a test of measures as applied.<sup>4</sup> The focus is on ensuring that Members' rights to avail themselves of exceptions are exercised reasonably so as not to frustrate the rights of other Members. In *US - Gambling*, as already indicated, the Appellate Body held that the US (federal) measures were necessary to protect public morals. However, it criticized their implementation: the US had not demonstrated that it applies its prohibition on remote supply of gambling services in a consistent manner, as between those supplied domestically and those that are supplied from other Members.<sup>5</sup> In other words the US had applied this measure in a discriminatory fashion. The measure in *US - Shrimp* did not survive the 'chapeau' analysis either, but after the issuance of revised guidelines to comply with the first *US - Shrimp* ruling, the US measure satisfied the 'chapeau' analysis.

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<sup>1</sup> Vienna Convention on the Law of Treaties, Artt. 31, 32: account should be taken of 'any subsequent practice in the application of the treaty which established the agreement of the parties regarding its interpretation' - Art. 31(3) (b)

<sup>2</sup> International Court of Justice, Statute of the Court, Art. 38 (listing the sources of international public law).

<sup>3</sup> One of such new international agreements is the Agreement on International Humane Trapping Standards (AIHTS) between EC, Canada and Russia imposing minimum standards for trapping furbearers species. However, one should bear in mind that the EC went for bilateral agreements, because it considered that unilateral measures would not withstand a WTO challenge.

<sup>4</sup> *United States - Standards of Reformulated and Conventional Gasoline*, (WTO, 1996a, p. 20).

<sup>5</sup> The Appellate Body ruled that : 'US has not shown, in the light of the IHA, that the prohibitions embodied in these measures are applied to both foreign and domestic service suppliers of remote betting service', (WTO, 2005a, para 369).



Any differences in treatment between imported and domestic meat, if any, will need a solid justification, as shown in US - Gambling. Moreover, in US - Shrimp<sup>1</sup>, the Appellate Body considered certain due process criteria, such as transparency, predictability or 'good faith' effort in negotiations also as important in this respect.

By way of conclusion:

- The justification of the contemplated measures as 'necessary to protect public morals' is very likely to be accepted;
- Their justification as 'necessary to protect animal health' depends on demonstrating that the measures are effectively necessary to protect animal health;
- The reliance on protection of the environment as a justification is doubtful to say the least, not only because it may be difficult to demonstrate links with animal welfare and public morals or animal health, but also because there does not appear to be any international agreement dealing with this matter;
- As to the 'chapeau' of Article XX, any difference in treatment between imported and domestic meat will need a solid justification.

The measures should not, under the guise of formal correctness with exceptions under Article XX, appear as introducing restrictions to trade, e.g. as a result of statements such as 'we need to keep out imported non-preferred meats to protect EC meat producers'.

### **3.2 The impact of the design of the contemplated measures**

A number of questions relate to the design of the measures that are contemplated. Several types are conceivable:

- (a) Labelling requirements showing that 'non-preferred' meat products do not meet a 'preferred' meat standard;
- (b) Import duty for 'non-preferred' meat products higher than the WTO bound duty or import duty for 'preferred' meat products lower than the WTO bound duty;
- (c) Charge on sales of 'non-preferred' meat products to maintain a level playing field for 'preferred' meat products with higher cost of production, either on imported 'non-preferred' meat alone, if all EC production meets the standards of 'preferred' meat, or on both imported and domestic 'non-preferred' meat, if the standard of 'preferred' meat is not mandatory for the EC production. It is assumed that no import ban on 'non-preferred' meat will be contemplated.

In a WTO perspective, the choice between these options is likely to be reviewed under the test whether the chosen measure is 'necessary', which in practice amounts to a proportionality test: i.e. could the interest which the measure chosen, e.g. measure (c), seeks to protect not adequately be protected by a lesser measure, e.g. measure (a)?

In the abstract and at this stage, it is difficult to predict what the outcome in this regard would be for any of the options. Even a lesser option such as labelling would not

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<sup>1</sup> US - Shrimp, (WTO, 1998b, paras 178-184).

shield the EC against a challenge in the WTO as shown by the US moves against GMO labelling by the EC.

In the (b) option, raising the customs duty for 'non-preferred' meat above the WTO rate bound by the EC<sup>1</sup>, is a possibility: 'unbinding' of customs duty rates is possible under Article XXVIII GATT. A price would, however, have to be paid by the EC to WTO Members with whom such 'bound' rate was initially negotiated and to WTO Members that have 'a principal supplying interest' or that have 'a substantial supplying interest' to the EC. That price consists of a lowering by the EC of the customs duty rate on other products exported by these WTO Members to the EC.

Lowering the customs duty on 'preferred' meat is also a possibility. It would not require 'unbinding', as WTO Members may also apply a customs duty rate lower than the bound rate. This could be challenged by WTO Members exporting 'non-preferred' meat to the EC. They would, however, have to establish that, in doing so, the EC breached Article I:1 GATT, i.e. that their 'non-preferred' meat is like 'preferred' meat exported by other WTO Members to the EC. We do not know whether other WTO Members will meet the EC standards of 'preferred' meat.

Reducing the customs duty applying to 'preferred' meat entails lower own resources for the EC budget. By how much is difficult to estimate, as long as the breakdown between imported 'preferred' and 'non-preferred' is not known. In addition, it is difficult to predict the impact on the consumers faced with 'non-preferred' meat whose price would increase.

The 'differentiated tax' option under (c) concerns two hypotheses. Under a first hypothesis 'non-preferred' meat continues to be produced in the EC and it is subject to the same tax as imported 'non-preferred' meat. In that event the EC has the defense that 'preferred' and 'non-preferred' meat are not 'like' and that the measure is origin-neutral. This defense would very probably succeed if a complaining WTO Member fails to establish de facto discrimination and cannot show that the measure burdens the imported meat disproportionately. De facto discrimination can be shown when differential taxes applying mostly to imported products (although formally to domestic as well) are not 'de minimis'. E.g., it has been held that:

'[a] large magnitude of tax differentials (50%) was capable of affecting the competitive relationship between pisco and western beverages in the market and hence afford protection to domestic industry of pisco.'<sup>2</sup>

Moreover, care should be taken to avoid that a new system does modify the conditions of competition solely for imported products, as such 'drastic reduction of commercial opportunity to reach, and hence to generate sales to the same consumers' was found to be a violation of GATT provisions.<sup>3</sup>

Under the second hypothesis, no EC produced meat may be sold in the EC unless it meets the 'preferred' meat standard. It is assumed that a defense under Article III would not be upheld on the ground that 'non-preferred' is directly competitive or substitutable to 'preferred' meat - why otherwise tax it less? In that event, the EC could probably fall back on

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<sup>1</sup> According to EC Regulation No. 1810/2004 (EC, 2004), these custom duty rates are 'bound' in the WTO.

<sup>2</sup> Chile - Taxes on Alcoholic Beverages (WTO, 1999, p. 14).

<sup>3</sup> Korea - Various Measures on Beef, (WTO, 2000b, p. 44).

the defense under the SPS or TBT Agreement. It could argue that rather than banning 'non-preferred' meat as not complying with the 'preferred' meat standard mandatory for the relevant meat products in the EC, it choose the less restrictive measure.

The question how a financial charge on 'non-preferred' meat should be calculated to prevail against WTO challenge is not easy to answer. However, there are some factors that would be relevant from a WTO perspective.

*First*, there must be a demonstrable link between the purpose of the charge and the way in which it would be calculated. The declared purpose may be to establish a level playing field with 'preferred' meat, the cost of production which is higher, or it may be to give an incentive to consumers to buy 'preferred' meat. The second declared purpose would be the better one.

*Second*, the charge should be calculated to reflect the purpose and should be in an amount that can be shown to be appropriate to the purpose and not going beyond what is necessary to achieve that purpose. How this calculation must be done is for economists to assess.

*Third* if 'non-preferred' meat would still be produced and sold in the EC, the financial charge should be applied in an equal manner, both formally and in practice, to domestic and imported 'non-preferred' meat,<sup>1</sup> i.e. the burden must be in practice the same.

### **3.3 Concluding remarks on compatibility with WTO rules**

- (a) Except where the contemplated measures would not affect imported meat disproportionately, 'preferred' and 'non-preferred' meat would very probably be considered as 'like products' and the treatment of imported 'non-preferred' meat less favorable than the treatment accorded to EC 'preferred meat'. The claim that the contemplated measures are not prohibited by Article III GATT is not likely to be upheld in a WTO dispute settlement proceeding.
- (b) Provided that the contemplated measures could be shown to come within the scope of the WTO SPS Agreement, i.e. that the measures are necessary to protect animal health, they must be scientifically justified in the absence of relevant international standards.
- (c) The contemplated measures could probably be justified as a 'technical regulation' under the WTO TBT Agreement, provided they are based on scientific assessment in the absence of relevant international standards.
- (d) Failing this, the contemplated measures would benefit from two of the exceptions of Article XX GATT: i.e. 'public morals' and 'animal health', provided that for the latter a clear link can be established between animal welfare and the health of the animals. They would meet the test of the 'chapeau' of Article XX GATT if the difference in treatment between imported and domestic meat rests on a solid justification and cannot be seen as essentially designed to protect domestic meat producers.
- (e) If the contemplated measures take the form of a labelling requirement, they are more likely to be upheld.

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<sup>1</sup> Dominican Republic - Cigarettes, (WTO, 2005b, para 86).

- (f) If the contemplated measures take the form of a higher customs duty rate for 'non-preferred' meat, a WTO procedure of 'unbinding' that rate will need to be followed and a price will have to be paid by the EC to WTO Members by way of lowering EC customs duty rates on other products.
- (g) If the contemplated measures take the form of a lower customs duty rate for 'preferred' meat, WTO Members exporting 'non-preferred' meat to the EC could claim that the EC infringes the MFN treatment of Article I:1 GATT if they show that other WTO Members export 'preferred' meat and thus benefit from the lower customs duty rate. They could still be justified under either the TBT Agreement or Article XX GATT.
- (h) If the contemplated measures take the form of an internal financial charge on 'non-preferred' meat and such meat may no longer be produced in the EC, they will very probably be held to be inconsistent with Article III GATT. They could be justified under the SPS or the TBT Agreement as less restrictive than a ban on imported 'non-preferred' meat. If 'non-preferred' meat may continue to be produced in the EC, the financial charge would probably be upheld under Article III: 2 GATT, if a complaining WTO Member fails to establish *de facto* discrimination and a disproportionate burden on imported meat.

## 4. Effects of PPM-labelling and tariff or tax differentiation

The preceding section has analysed the likely admissibility of the proposed measures under WTO rules. This section discusses the likely effects of the various proposed measures in turn: labelling, differentiated tariffs and differentiated taxes. In so doing, the analysis of section 3 is temporarily ignored. The concluding section ties the results of the two sections together.

Predicting the precise effects of measures, such as labelling, on the relative shares of various segments of the product market in question is possible only with more detailed analysis of consumer preferences and cost considerations in raising animal welfare. The discussion here is therefore primarily qualitative in nature.

The comparison of the various measures uses a range of criteria, summarised as the following:

- Market effects;
- Effectiveness in raising PPM standards;
- Implementation issues.

Market effects include the impacts that the measures have on prices, quantities and product qualities in various market segments differentiated either geographically or by quality. An analysis of likely market effects permits an examination of overall effectiveness. Various stakeholder groups are likely to interpret effectiveness in different ways. Here effectiveness is judged as the contribution towards improving PPM standards in the Netherlands, the EU and elsewhere. In addition to considerations of price, quantities and qualities, the discussion below proposes to include the implementation issues of the various instruments. These may also involve economic costs, more specifically transactions costs for producers or governments. They are identified separately given their different nature.

From an economic perspective, an assessment of effects on welfare of producers and consumers (net benefits) and the overall efficiency would also be desirable. In particular, expected impacts on the economic welfare of different groups (producers, consumers; foreign, domestic) also helps to predict the likely receptiveness of these groups to the various measures. Efficiency is interpreted economically as meaning that the policy option is chosen that produces the greatest benefits for the lowest cost. But the estimation of such benefits, in terms of consumers' and producers' surplus, is a difficult task with differentiated products, and where consumers' benefits are determined partly by animal welfare standards. Such an analysis would require further study.

The effects of alternative policy measures need to be examined in the context of existing standards and differentiation in the market for meat products. In this regard, some basic information on meat markets is presented in the boxes and tables below at the end of this sub-section. The current situation is one in which there are at least three different standards in effect covering production and process methods of meat products for the European

market: the existing European standards, the European standards for organic farming, and foreign standards (which can differ among countries). The organic standard is the highest and this is partly regulated by the government in that the standard has been set by EC regulation. Foreign standards, which may vary from country to country, are generally lower than current European standards. Aside from these standards, there are initiatives in the Netherlands and elsewhere where some producers are improving their standards of animal welfare, but without adopting organic standards, which cover other aspects of production. Such initiatives were mentioned in chapter 2.

In the analysis that follows, the various instruments are not presented as mutually exclusive alternatives. They sometimes have to be combined. Thus, mandatory or voluntary labelling requires a set of standards for the different label categories. Similarly, tariffs or taxes that are differentiated according to production methods also require a set of standards to distinguish between the types of products, regardless of whether such products are labelled for consumers. A *mandatory* production standard for animal welfare, agreed at international level, does imply though that only one quality level will be available in the market and other measures (labelling, differentiated tariffs or taxes) would be meaningless. For these reasons, the discussion begins with labelling, then moves on to differentiated tariffs followed by taxes.

#### **4.1 Labelling**

There are two main ways in which increased labelling options might be implemented to influence the current market situation. These are represented in the two situations depicted in Figure 2.1 of section 2 with respect to the policy goal of improving PPMs in the area of animal welfare. First, labelling could be introduced that allows consumers to identify whether or not meat products meet the European standard. Such labelling could be regulated and supervised by government authorities, but left as a voluntary decision for producers. Alternatively, such labelling could be made mandatory. This labelling is intended to stimulate foreign producers to adopt EU standards by making it clear to consumers that such products differ from those produced in the EU. This labelling could potentially be combined with country-of-origin labelling (COOL), highlighting the differences in standards between producing countries.

A second way in which labelling might be implemented intends to also provide incentives for domestic producers to increase their standards. This would be by means of regulation of standards above the minimum standard but aside from the current regulation of the organic standard. This policy option has recently been discussed in the context of a 'point' system ('stippensysteem'), or welfare index. This means that government authorities would regulate, in consultation with producers, what stricter standards would be that would qualify for more points on a label, as is done for the organic standard. Note that this would effectively also include the first option in that the labelling scheme could also cover products that do not meet the European standard, either with an explicit label or by the absence thereof.

The effect of labelling on foreign producers to increase PPMs related to animal welfare to comply with minimum European standards clearly depends on how consumers react

to this information. There are various possible scenarios and situations, depending on how such labelling is implemented. Domestic producers are likely to use this differentiation in their marketing strategies, pointing out the added level of animal welfare. A certain number of foreign producers, perhaps under pressure from their domestic import and retail partners, are likely to do what is necessary to increase their standards in order to qualify for the minimum standard. Other research carried out by LEI for the Dutch poultry industry association has suggested that it may not be very difficult for Brazilian chicken meat exporters, for example, to adapt to European 'sustainability' standards that affect market access.<sup>1</sup> But for some other exporters, such as those in Thailand, this adjustment may be more difficult or expensive. So some will simply remain in the unlabelled segment and the relative proportion of the two groups will depend on both consumer preferences and the strategies pursued by importers, processors and retailers.

Providing new additional standards, such as a range of one or more points, above the existing two standards, would likely increase the confidence of consumers in the information provided on existing meat product labels. This applies in particular to meat producers who are attempting to differentiate their products on the basis of animal welfare in production, without producing to the organic standard which also includes requirements concerning animal welfare. Indeed the organic segment of the market is currently regulated with a voluntary labelling scheme. Consumers who are attracted by meat products meeting a higher standard (though not necessarily the organic one) are likely to trust that the label, when this standard is officially recognized and certification is regulated by law.<sup>2</sup> So the market for products that meet say a 2-point animal welfare standard which is between the minimum and organic standards, may expand. Some other producers may thus be stimulated to increase their standard of production from the minimum 1 point to the 2-point.

The extent to which animal welfare standards improve in meat production, either in foreign countries or within the EU, thus depends heavily on the reactions of consumers to the differentiated products and the associated price difference. For the first labelling option (minimum EU standard), the question is to what extent there are consumers who would like to purchase meat products that score better on animal welfare but who are much less concerned about other attributes of organic meat products, such as the type of feed used. With the provision of extra information, a number of consumers who do not normally consider organic products, may be inclined to choose for meat products that meet the EU minimum standard.

For the second labelling situation (a point system for improved standards), the benefit to consumers from more choice through a point system will relate to how much this new segment of the market grows and also on the perceptions of products that are unlabelled. Growth in the market for higher standard products will be determined by the proportion of consumers who are willing to pay somewhat more for an improved standard of animal welfare, but are not interested in purchasing all the attributes attached to organic production. There are reasons for expecting this to be a limited segment of the market. As mentioned, a certain number of consumers who are concerned about purchasing animal-friendly meat and are willing to pay more for this already have a choice that meets their concerns. In-

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<sup>1</sup> Information provided by LEI researcher, Peter van Horne; the research has been undertaken for NEPLUVI.

<sup>2</sup> See Golan et al. (2000).

deed, the situation with voluntary labelling of hen-friendly egg production standards would seem to support this expectation, but there is still very little research on which to base such predictions.<sup>1</sup> On the other hand, a relatively stronger effect may be observed with labelling of minimum standards. But this does not serve, in the first instance, to raise standards in the EU.

Citizens and interest groups in the Netherlands and some other European countries have exhibited increasing concern for the protection of animals in the livestock sector. More and more, consumers seek guarantees that the supply of animal products is in accordance with their preferences on methods of production in the meat and dairy industries. In that sense, animal welfare is evolving from strictly a public issue into a marketing issue as well.

When it comes to the marketing of products that carry attributes of animal protection (or environmental protection, for that matter), recent research records a dichotomy between citizen concerns and consumer purchase behaviour. Beekman et al. (2002) explored the options for market-driven improvements of animal welfare on pig farms. Ingenbleek et al. (2004) examined the conditions for a welfare index, or point system, with consumers, consumer organisations, and with the retail sector. The main conclusions are summarised here.

*Perceptions.* Consumer perceptions of the living conditions of livestock align quite well with those of experts on (farm) animal welfare (Beekman et al., 2002). Yet, consumer ideas on animal-friendly systems of production are miles apart from current practice in animal husbandry: common husbandry practices (that follow regulatory standards) are deemed unacceptable; and technically more advanced levels of animal protection are perceived as the bare minimum.

*Segmented markets.* Consumers can, in theory, be classified into groups of people who share similar preferences with regard to animal welfare. In terms of preference ranking, in general animal welfare is given less priority than product safety but it has been described as a factor of increasing importance (Ingenbleek et al., 2004, pp. 34). More and more consumers seem to prefer that all animal products comply with a minimum level of animal protection, which the government should guarantee (Beekman, 2002). Among these, there are those who do not want to be bothered with the details on animal welfare; the minimum level that they deem acceptable does not motivate them to alter their purchase behaviour, or to spend additional sums on animal welfare. Other consumers have an additional interest in *levels* of animal welfare, and are prepared to vote for this issue with their purchase behaviour. In this set, as quoted by Ingenbleek et al., some groups of people are over-represented, including women in general, higher-educated individuals, and 'animal-lovers' (Ingenbleek et al., 2004, pp. 27). These consumers, some of whom already choose to purchase differentiated products of organic or free-range quality, may benefit most from the labelling of an animal welfare indicator on meat and dairy products.

It appears though that the premium that most consumers are prepared to pay for animal welfare attributes is limited, relative to potential costs. Eggs provide an interesting example. Burrell and Vrieze (2000) surveyed more than 350 Dutch egg consumers in 1999 and found that levels of concern about hen welfare among consumers was high and such

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<sup>1</sup> A system of voluntary labelling for a range of classes of egg quality, including animal welfare attributes, has existed in the Netherlands since 1990 and falls under European Directive



consumers indicated that they were hypothetically willing to pay, on average, a price premium of 30%. Burrell and Vrieze highlight though that this is not translated into actual purchase behaviour in the marketplace. This may indicate, for example, that consumers would prefer to see higher standards, for which they would be willing to pay more. But, for a variety of reasons, they will not pay more on their own volition, if their fellow consumers are not obliged to do so.

In general, consumer research indicates that the impediments to increased purchasing of meat and dairy products with higher animal welfare PPMs include relative price gaps over normal products; the lack of information and trust, and the loss of a sense of connection to the livestock industries (Beekman et al., 2002). Labelling can improve the provision of information and its regulation increases the level of trust. The accompanying use of communication tools may also help. For example, the study by Burrell and Vrieze (2000) on eggs indicated that more consumers might purchase the more hen-friendly varieties of eggs currently available, if they had a better understanding of the labelling system. The potential to reinforce these strategies with economic instruments that seek to reduce the price gap is discussed in the next two sub-sections.

Aside from consumer reactions, decisions at the distribution, processing and marketing stages of the supply side, not just at the level of primary production, will also influence the outcomes. There is little information available but indications are that the costs of meeting higher animal welfare standards on-farm could be quite considerable (Brouwer, Dwyer and Baldock, 2002) and probably more than the cost of improving other 'sustainability' standards. Aside from direct costs from choosing to meet a higher PPM standard, producers, processors and retailers also incur costs for segregating the supply chain, or identity preservation, traceability and labelling of products. These costs can apply to both segments of the market i.e. products that meet the PPM standard, as well as those that do not. For example, foreign producers of meat products that do not meet the EU standard would incur some costs associated with labelling their product. More importantly, though, where the supply chain involves multiple sourcing from various countries, processors, wholesalers and retailers may have to consider measures to segregate their supply processes into two (or more) PPM quality standards. Such measures create costs that are effectively born by both product segments. The magnitude of such costs can be expected to vary according to the product in question, for example fresh packaged or processed. If the costs are large enough in relation to overall costs, then producers and processors have an incentive to limit their supply chains to only one segment, in order to avoid these segregation costs. This could then lead to a stronger incentive for foreign producers. For example, a decision by retailers to market only meat products meeting the EU minimum standard, as opposed to also including products that do not meet the standard will then have a stronger effect on foreign producers. Further research among firms in the sector could estimate the extent of foreign and multiple sourcing, as well as the likely response of importers, processors and retailers to alternative labelling schemes.

From a theoretical perspective, the effects of a labelling scheme are likely to become stronger if made mandatory, which means that there is clear labelling even when an imported product does not meet the minimum European standard. The incentive for foreign suppliers of such products to move to the European standard will become stronger, in order to avoid the negative association with the lowest category. Furthermore, mandatory label-

ling could increase the importance that consumers attribute to this information. Nonetheless, the incentive to participate in voluntary labelling, for marketing purposes, would probably also be quite strong, making the additional effect of mandatory labelling difficult to gauge.

In summary, labelling of meat meeting the EU minimum standard can be expected to have some positive effect on the level of animal welfare in PPMs in exporting countries. The extent to which a regulated (supervised) labelling scheme for one or more gradations of better PPMs, such as with a point system, are harder to predict. Based on existing, though limited, research on consumers, relatively little demand for differentiated meat products embodying higher standards of animal welfare in the EU can be expected. Nonetheless such a scheme would probably incorporate the same positive effects on foreign producers as the simpler labelling of a minimum standard as this would be either implicitly or explicitly included. To address consumer reluctance to choose for more expensive products with higher animal welfare product methods, labelling could be combined with financial incentives. The next sub-section addresses differentiated tariffs and the subsequent one, differentiated taxes.

## **4.2 Differentiated tariffs**

Two policy measures have been proposed for reinforcing labels and standards with financial measures: differentiated tariffs and differentiated taxes, in particular consumer taxes. The main difference between tariffs and taxes is that tariffs would be a border measure differentiating only between domestic and foreign products according to animal welfare in production methods, whereas taxes would apply to all products on the domestic market. Differentiated tariffs or taxes should really only be contemplated together with the use of mandatory labelling and standards. With such measures, producers, particularly of products that meet standards qualifying for lower tariff or tax rates, will have a strong incentive to convey this information to consumers. The latter would probably benefit from a labelling scheme that is regulated in order to ensure the provision of clear and trustworthy information. Differentiated tariffs or taxes can thus be seen as serving to enhance the effectiveness of a labelling scheme.

The additional effects of tariffs will depend on options or scenarios concerning the nature of the differentiation applied. For example, if tariffs for meat products are differentiated according to two or more standards of animal welfare in production, then this could, in theory, be achieved by *reducing* the tariff rate for products that meet a higher standard, or by *increasing* the tariff rate for existing products.

What would be the effect of higher import tariffs in the EU on meat products that do not meet the EU's minimum standard? This would probably reduce the market share of such products. Foreign producers would have an incentive to adopt EU minimum standards, depending on the size of the tariff. Given the general cost advantages enjoyed by such producers for the basic factors of production (land, labour, energy, etc.), it could be expected that they would be able to adopt such standards without too much difficulty within a few years.

Higher import tariffs will raise market prices to some extent, depending on the extent and pace of adaptation by foreign producers, and thus benefit domestic producers whose market share may increase. Consumers will pay higher prices for meat, though, according to the extent to which price increases are passed on through the marketing chain.

If on the other hand, import tariffs were lowered for products that do meet the EU's standard, then it can be expected that more foreign producers, either on their own initiative or under pressure from their importing partners, would adjust their production standards in order to take advantage of the lower tariff. This would lead to increased market share for imported meat products, relative to domestic products. Lowering tariffs effectively reduces the cost of serving the European market for foreign producers who can meet the standard. The average price level would also decline, but the extent to which this is passed on to consumers depends on market structure and the nature of competition in the processing, wholesaling and retail sector.

From a longer term point of view, this does seem to imply permanently lowering the applicable tariff for meat products in general. If it is intended that foreign producers would move to adopt European minimum standards over time, spurred on by the lower tariff, then the promise of this lower tariff would have to be relatively certain. In other words, foreign producers would expect some assurance that it would not be raised again.

In order to have an effect on the decisions of foreign producers, a tariff increase or decrease would have to be greater than the additional cost for producers of meeting the EU's standard. Producers vary considerably in their cost structures and levels, thus a chosen level will be an incentive to some lower cost producers but not to others. Determining an appropriate level requires data on such additional costs and would be a complicated task. An estimate of the additional costs of meeting EU standards for European producers could provide a useful starting point. Given the overall cost advantage of foreign producers, their additional costs are likely to be no higher than those of European producers. This means that a tariff based on European producers' additional costs would likely have an effect on foreign producers, leading many of them to increase their PPM standard. On the other hand, this may be higher than necessary, or not proportionate in WTO terms, and possibly require justification in an eventual WTO dispute resolution process.

These points should be borne in mind when considering the distribution of the effects of differentiated tariffs on domestic versus foreign producers. The initial effects of a higher tariff, for example, might favour domestic production. But if the tariff has its intended effect of providing an incentive for a substantial portion of foreign producers to increase their standards, then these producers are likely to regain market share.

It is also possible to combine tariff reductions for products meeting EU production standards with increases above current levels for those products not complying. This means that the tariff increases and decreases for the respective product types would be less than if there only a tariff increase or only a tariff decrease. It may be possible to do this in such a way that leads to relatively neutral effects in terms of market shares and prices, as well as tariff revenues. But over time foreign producers will adjust and other market factors will change, meaning that the neutral character would likely only be temporary, with the chances being that the balance will shift towards an overall average tariff reduction.

As mentioned in section 3, a higher tariff for products not meeting the EU minimum standard would probably require a renegotiation of the bound rate for such products with

trading partners at the WTO. This clearly poses more difficulties than lowering a tariff for products that do meet the minimum standard, which would likely lead to fewer complaints from exporting countries. A further complication with differentiated tariffs is that it would be necessary to incorporate this distinction into ongoing discussions within the Doha Round to ensure that the incentive remains in the next agreement on agriculture.

Implementing differentiated tariffs also involves border measures to check the standard of imported meat products. While this may only involve a verification of labels, the extent to which such tasks may pose complications for custom agencies should probably be investigated further.

### 4.3 Differentiated taxes

Differentiated tax rates could be an additional financial instrument, at least in theory, for stimulating consumers to purchase meat products with higher animal welfare PPMs. This provides producers with more of an incentive to adopt higher standards. As explained earlier, differentiated taxes apply to all products on the domestic market, whether domestically produced or imported. There are two settings in which one can consider applying differentiated tax rates. They could be designed to have a similar effect as differentiated tariffs, by distinguishing between products that do versus those that do not meet the minimum standard applicable in the EU. Differentiated taxes could also be designed to accompany a labelling scheme, such as the welfare index or point system, that aims to raise standards of production within the EU. Both situations are discussed here.

Before considering the two situations in turn, it is important to highlight the types of tax measures possible. Differentiating value-added tax (VAT) according to PPMs has been proposed before, both in the context of 'green taxation' but also specifically for animal welfare.<sup>1</sup> The European Court of Justice has however determined that differential VAT rates for competing substitute products is not permissible and would violate the principle of fiscal neutrality.<sup>2</sup> An alternative fiscal instrument could be a consumer, or excise, tax on meat products, differentiated according to PPMs. In the discussion here, the proceeds from such a tax would not necessarily have to be earmarked ('bestemmingsheffing') for financing activities with respect to animal welfare.<sup>3</sup> Examples of special excise taxes exist for certain other products (e.g. disposal tax, or 'verwijderingsbijdrage', on appliances) but a number of implementation complications arise which have previously been mentioned in relation to proposals for mechanisms to finance the destruction of animal carcasses.<sup>4</sup> The discussion below mentions these difficulties together with a review of the likely effects of such measures.

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<sup>1</sup> For example, by CLM (2003).

<sup>2</sup> A summary of this argument and the case in question, concerning French pharmaceutical medicines, is provided in the letter from Minister Veerman (Agriculture, Nature and Food Quality) to the Dutch Parliament of 15 July 2004 ('BTW-tarief op vlees' TRC 2004/5357).

<sup>3</sup> As was also proposed by CLM (2003).

<sup>4</sup> For example, the letters from Minister Veerman (Agriculture, Nature and Food Quality) to the Dutch Parliament of 6 October 2003 ('Consumentenheffing ter financiering van destructiekosten' TRC 2003/7369) and of 19 December 2003 ('Consumentenheffing op dierlijke producten' TRC 2003/9035).

In the first setting discussed above, a fiscal instrument could be used to impose a surcharge, or tax, on products that do not meet a minimum standard applicable to production within Europe. Such a higher tax rate would apply only to some portion of imported products, since all products produced within the EU must meet the standard. The effects would therefore be similar to a commensurate tariff increase, as discussed above. Overall prices would probably rise and the market share of foreign products would decrease, at least temporarily, depending on the size of the tax difference and the ability of foreign producers to adopt the standards. But in this case, a consumer tax would be rather difficult to implement. Given the organization of the meat supply chain, a tax or surcharge would have to be levied somewhere in the processing or distribution stages of the supply chain.

In this case, where the fiscal measure is only targeting foreign products, the alternative of a *lower* tax rate for products that meet existing standards in Europe is difficult to realize without an obvious tax that could be reduced. In theory, one could consider a subsidy for such products which would then contribute to lower market prices and provide steeper competition for EU producers. This kind of subsidy is not realistically feasible. Most simply, it creates almost permanent and considerable demands on public finances.

In the second setting, differentiated consumer taxes could be proposed for products according to the standard which they meet, in a situation where a range of such standards have been established, are regulated and conveyed to consumers by means of labels. The tax would be highest for products only just complying with the EU minimum standard, and then incrementally lower for products with higher standards, such as one and two points. Such taxes would clearly raise prices and lower production, both in the EU and in exporting countries, since the overall tax burden on the sector is being increased. If the tax differentials were large enough, this would lead to more domestic producers increasing the standards of their production over time, but potentially at considerable cost in terms of employment and incomes.<sup>1</sup>

There are now two options in the second setting for treatment of meat products (of foreign origin) that do not meet the EU minimum standard. The first option is that the differentiated consumer taxes scheme could take these products into account with the highest rate applying. A second option is to have the differentiated taxes apply only to products meeting the EU minimum standard or a higher standard, and combining this with differentiated tariffs. Specifically, in order to maintain consistent incentives, the option of higher tariffs for products not meeting the standard would be chosen and set so that the incremental increase in the tariff would be greater than the additional increase in the tax rate applicable for domestic products only just meeting the European standard. Designing a system of consistent financial incentives in this case would be quite difficult, and perhaps unfeasible. A further complication arises with respect to organically-produced meat products as the system of differentiated taxes would also have to incorporate this standard.

Given that these differentiated consumer taxes would consist of a new tax instrument, a difficulty similar to the one described above arises in designing a system of *lower*

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<sup>1</sup> The effects increasing the tax burden on the meat sector have been estimated in a review of the proposals by CLM (2003) to increase the VAT rate applicable for *all* meat products from the current 6% to the general level of 18% to finance the destruction of carcasses (see Bunte 2003, included in the letter of Minister Veerman (Agriculture, Nature and Food Quality) to the Dutch Parliament of 19 December 2003 ('Consumentenheffing op dierlijke producten' TRC 2003/9035)).

taxes. This means that a subsidy of some form is, in effect, the only way to offer an incentive that eases, as opposed to increases, the tax burden. Again, this impinges on the uniformity of the fiscal system and creates an additional demand on public finances that would only become larger as more and more producers adopt higher standards. The market effect, as for any subsidy, would be to lower prices and increase the returns to meat production. These effects would also carry over to foreign producers who could produce for the higher standards and would also partly enjoy the benefits of the subsidy.

Raising or lowering tax rates for specific products raises other issues about the design of the fiscal system, many of which have been alluded to above, such as the duration of such a differentiation. In general tax increases would be preferable to decreases or subsidies, in part because of the more permanent effect the latter have. On the other hand, raising taxes will probably generate more criticism and opposition among producers, processors and retailers, compared to reducing taxes. Implementing a differentiated tax system for meat products would probably be administratively difficult for the tax authorities. One major problem for a consumer tax would be how to deal with processed products where different types of meat, potentially of different standards, are combined. Furthermore, differentiated taxes would have to be pursued at a European level; otherwise large diversions in the border zones and of intra-EU trade could be expected.

The next section summarises the results of the assessment of all three options and relates these to the findings of section 3.

## 5. Conclusions

In the preceding sections, the various options under consideration for improving animal welfare in PPMs of meat production - labelling, differentiated tariffs, and differentiated taxes - have been examined on grounds of both admissibility and effectiveness. Assuming that an international agreement on standards for animal welfare in farm production is not yet concluded, Section 3 has analysed how such measures could be defended against complaints that they were inconsistent with GATT principles. First, it was concluded that such measures could possibly be justified under the TBT Agreement. Second, a defence could be made based on the exceptions offered by GATT Article XX, in particular with respect to 'public morals'. There have been few cases from which inferences can be drawn but it appears that a solid case, demonstrating the concern of citizens in the EU to animal welfare, may well be upheld in a dispute settlement procedure.

Section 4 has analysed how the likely effectiveness of the measures varies. These findings are now summarised (see Table 5.1), maintaining the distinction between goals of improving levels of animal welfare in meat production among domestic versus foreign (outside the EU) producers. This is then followed by some reflection of the combined implications of both types of analysis for policy and further research.

Labelling of whether meat products meet the EU minimum standard can be expected to have moderate effects on improving PPMs in exporting countries. On the other hand, the discussion above has presented reasonably strong grounds for expecting that a regulated scheme of voluntary labelling of improved standards in the EU may not have much impact on producers there, given the admittedly limited information on probable consumer reactions.

The effectiveness of labelling could be increased with the use of financial incentives in the form of differentiated tariffs or taxes, which are in effect complements, not alternatives, to labelling. Differentiated tariffs or taxes imply the segregation of markets by identity preservation, and producers can be expected to convey this information on their products to consumers.

Differentiated tariffs primarily affect foreign products and could be used to provide greater incentives to meat producers in countries exporting to the EU to adopt its minimum standard for animal welfare. The additional effects of differentiated tariffs on market shares and prices is likely to be modest while a considerable improvement in standards among exporters could be expected. Tariffs could be either increased for products not meeting EU standards or decreased for compliant products. The choice affects the nature of the market effects. The principal difficulties with tariffs concern the renegotiation of bound rates in the case of tariff increases, or the increased competition on the domestic market in the case of decreases.

*Table 5.1 Comparison of various measures*

|  | <i>Domestic<br/>Production</i> | <i>Imports</i>                | <i>Prices</i>                  | <i>Average PPM Stan-<br/>dard (<u>D</u>omestic vs<br/><u>F</u>oreign)</i>              | <i>Implementation<br/>Issues</i>   |
|--|--------------------------------|-------------------------------|--------------------------------|--|--|
| <i>Labelling of<br/>standards</i>  |                                |                               |                                |  |  |
| - for products<br>meeting EU<br>minimum stan-<br>dards   | Little effect                  | Likely to be<br>little effect | At most<br>small in-<br>crease | D: no change<br><br>F: moderate/ con-<br>siderable improve-<br>ment                    | - Assessing confor-<br>mity of standards in<br>exporting countries<br><br>- Rules for labelling<br>of processed products   |
| - for higher<br>standards (e.g.<br>point system)   | Little effect                  | Likely to be<br>little effect | At most<br>small in-<br>crease | D: little/moderate<br>improvement<br><br>F: moderate/<br>considerable im-<br>provement | <i>SAME AS ABOVE</i>   |
| <i>Tariffs</i>   |                                |                               |                                |  |  |
| - <i>Higher</i> tariffs<br>for products<br>NOT meeting<br>EU standards                                       | Small increase                 | Small<br>decrease             | Small in-<br>crease            | D: no change<br>F: considerable im-<br>provement                                       | - Determining level<br>- Collection measures<br>(at border)<br>- Need to negotiate<br>unbinding of rates   |
| - <i>Lower</i> tariffs<br>for products<br>meeting EU<br>standards  | Small de-<br>crease            | Small<br>increase             | Small<br>decrease              | D: little/no change<br>F: considerable im-<br>provement                                | - Determining level<br>- Collection measures<br>(at border)  |
| <i>Taxes</i>   |                                |                               |                                |  |  |
| - Tax <i>increases</i><br>of larger<br>amounts for<br>products with<br>lower stan-<br>dards                  | Decrease                       | Decrease                      | Increase                       | D: considerable im-<br>provement<br>F: considerable im-<br>provement                   | - Need new special<br>excise tax<br>- Preferably for all of<br>EU<br>- Designing consis-<br>tent incentives for all<br>segments including<br>foreign and organic |
| - Tax <i>de-<br/>creases</i> /<br>rebates of lar-<br>ger amounts<br>for products<br>with higher<br>standards | Increase                       | Increase                      | Decrease                       | <i>SAME</i>  | <i>SEE ABOVE</i> +<br>- Increase in public<br>spending of undeter-<br>mined duration<br>(subsidy)  |



Differentiated taxes or rebates would provide much stronger incentives for producers in the EU to improve their animal welfare standards in PPMs. But designing and implementing such a system poses even more difficulties, some of which may be insurmountable. A new tax would probably have to be created, preferably with commitment from many if not all EU members. Ensuring that incentives were consistent among the various standards proposed, including existing organic standards, seems complicated. Rebates raise the possibility of a considerable demand on public finances.

Considering the two forms of analysis reveals some parallel between the relative effectiveness of the various measures, in terms of improving PPMs, and the likelihood of an official complaint by other WTO members. This is logical since greater effectiveness in terms of raising standards would also be associated with greater effects on trade in meat products. Labelling can be expected to have only moderate effects on foreign producers and even less on domestic producers; this is least likely to be subject to a dispute. Differentiated tariffs would have a stronger effect on foreign producers but could possibly be challenged as being inconsistent with the most-favoured nation (MFN) principle, if this results in producers in some, but not all, exporting countries shifting to the EU standard. It is questionable whether an exporting country would want to bring such a case, if some of its exporters were indeed prepared to produce for the EU standard. A differentiated tax that incorporated a rate for foreign products not meeting the EU standard would potentially be the most effective measure (though perhaps administratively the most complicated). This could also lead to a challenge under Article III of the GATT. It is worth emphasising though that the reasoning here concerns the possibility of a dispute in the WTO. The analysis in Section 3 has concluded that a defence against either of these types of complaints may have a good chance of succeeding, either under the TBT Agreement or by resorting to Article XX.

Some tentative policy recommendations for measures to improve animal welfare in farm production in countries exporting to the EU can be derived from combining the judicial and economic analysis. Labelling of meat products that distinguishes between those that do and those that do not meet the European standard may be a logical starting point. The extent to which this is effective could be monitored. Then, at a later stage, if the results are not judged to be satisfactory, a proposal to differentiate tariffs might be considered. In this manner, a stronger case could be made that tariffs were a necessary and proportionate measure. And, as has been argued, tariffs would in any case have to be accompanied by some form of labelling.

With respect to providing incentives for domestic producers to improve animal welfare standards, a regulated labelling scheme might also be the best place to begin. The expected effects are likely to be more modest than for labelling of products that only meet EU minimum standards. But an additional benefit would be to improve the trustworthiness and transparency of information provided to consumers on labels, given that a number of producers are establishing their own private label schemes that involve some aspects of animal welfare. In this case though, the potential for reinforcing the labelling scheme with differentiated taxes, or some other fiscal measure, seems limited. This is due less to potential conflicts with WTO rules, but more to implementation difficulties and precedents under European law. These issues could, of course, be further addressed and investigated in the interim.

The proposed order of first labelling, with reinforcement possibly coming later by means of a financial incentive also offers more opportunities for individual member states, such as the Netherlands to undertake initiatives, while perhaps negotiating a common or joint approach across the EU. Individual countries, or a small group of neighbouring countries, could devise and implement labelling schemes of either type suggested above. It should be born in mind however that subsequent harmonisation of labelling initiatives across countries could be tedious. Both differentiated tariffs or taxes, on the other hand, are measures that would have to be implemented at European level. Import tariffs are a matter of EC responsibility. A tax measure could be implemented nationally but could then lead to unintended distortions in trade flows within the EU, and also presents difficulties in border zones where consumers can easily purchase in neighbouring countries. However, pilot initiatives with tax measures may perhaps be considered at (sub)national level, in order to investigate their possible effectiveness.

The assessment of the effectiveness has been necessarily quite simplistic given the information available. A number of issues can be identified for further analysis to inform policy makers and other stakeholders, before any decisions are taken.

First, the effects of production and prices identified in Table 5.1 and discussed above are necessarily qualitative in nature. A quantitative assessment of the contemplated measures could be undertaken. This could be done for specific sectors of meat products although the precision would be constrained by the availability of trade data, which is not segregated at the level of different meat product market segments. Furthermore, information on the cost structures in the meat supply chain (both domestic and foreign) is rather limited, as is data on the costs of segregating the supply chain and maintaining identity preservation. Of particular importance here are the costs for different producers in various countries to adopt better animal welfare standards. Little is known about these costs, but they have been identified as possibly being quite significant in comparison to other types of sustainability costs (Brouwer and Ervin, 2002). A key element also concerns the distribution of consumer preferences for animal welfare in meat production. Nonetheless, a quantitative analysis could be based on a number of scenarios and sensitivity analysis with respect to variables for which data is limited or lacking. This would allow a more detailed assessment, for example, of the effects on prices and quantities produced and imported, as well as simply a more precise description of proposed measures. Perhaps of equal importance, it would allow an assessment of the impact on the economic welfare of consumers and producers (both domestic and foreign).

The following is a list of some other issues for further investigation:

- The possibilities for labelling of different standards, including mechanisms necessary for controlling standards in exporting countries;
- The feasibility of implementing a differentiated tariff by the customs agencies;
- Similarly the specific possibilities for a differentiated tax or rebate, which is also being discussed in relation to organic products.

Finally, this report has concentrated on the specific case of animal welfare in meat production. The analysis and the results do also have implications for other sustainability concerns, particularly those that have received less attention in WTO discussions and dispute cases. A possible defence of measures concerning non-product-related PPMs with

appeal to Article XX needs to be examined on a case-by-case basis. Relatively modest measures for labelling of products are less likely to incur a challenge in the WTO but may also be less effective, depending on the product and concern in question. The proposal for applying differentiated, or preferential, tariffs is rather novel and may offer more opportunities of passing the proportionality requirement than more drastic measures, such as import bans or mandatory technical standards. Aside from WTO admissibility though, it is equally important to investigate the administrative feasibility as well as the effectiveness of any contemplated measures.

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