

Distrust and barriers to international trade of food products: an analysis of the *US — Poultry* dispute

Christophe Charlier

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Université de Nice - Sophia Antipolis and GREDEG/CNRS

christophe.charlier@gredeg.cnrs.fr

Preliminary version

Abstract

Is the *United States — Certain Measures Affecting Imports of Poultry from China* case (*US - Poultry*), arbitrated by the Dispute Settlement Body of the World Trade Organization, simply one more sanitary and phytosanitary (SPS) dispute? The possibility the Panel had in this dispute to always base its reasoning on the way Panels and Appellate Body did on previous SPS cases can give this impression. This paper argues, however, that a closer examination of the dispute with the help of economic analysis permits to show that the US – Poultry case is highly original. This dispute opposing China as complainant to the US as defendant was raised by the unilateral breaking of the US equivalence regime procedures for Chinese poultry products. China claimed that this decision was not based on a risk assessment and was not compatible as a consequence with the SPS Agreement's exigencies. China also supported that this Section was discriminating and contradicted the Most Favoured Nation principle of the GATT 1994 Agreement. The economic analysis developed in this article permits to give another interpretation of the case than the Panel's one highlighting the importance of trust.

Keywords: WTO, SPS Agreement, MFN, Nontariff Barrier, Product safety

JEL Codes: F130, K320, K330

1 Introduction

Is the *United States — Certain Measures Affecting Imports of Poultry from China (US - Poultry)* case,¹ arbitrated by the Dispute Settlement Body of the World Trade Organization (WTO), simply one more sanitary and phytosanitary (SPS) dispute? The possibility the Panel had in this dispute to always base its reasoning on the ways Panels and Appellate Body did on previous SPS cases can give this impression. This paper argues, however, that a closer examination of the dispute permits to show that the US – Poultry case is highly original. The US – Poultry dispute opposing the People’s Republic of China (China) as complainant to the United States (US) as defendant is raised by Section 727 of the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act (AAA) of 2009 (Section 727). Section 727 states that "None of the funds made available in this Act may be used to establish or implement a rule allowing poultry products to be imported into the United States from the People’s Republic of China." This section has the effect to impede China’s exports of poultry products to the US.

The US regime for the importation of poultry is set in the Poultry Products Inspection Act (PPIA), and the conditions under which poultry products are allowed to be imported in the US are inscribed in the US Code of Federal Regulations. The concerned rules and regulations regarding the inspection of poultry products are set by the Secretary of Agriculture of the USDA. The ‘equivalence’ based regime for obtaining permission to import poultry and poultry products into the US that is thus created is intended on a country-by-country basis and run by an agency of the USDA called the Food Safety Inspection Service (the FSIS). This ‘equivalence’ regime is implemented as soon as a country applies. The FSIS determine the equivalence of the applicant country’s inspection system with the US one on the base of a document review (evaluation of the country’s laws and regulations) and of an on-site audit (evaluation of the concrete implementation of the regulatory regime).² If the country is found eligible, the FSIS publishes successively a draft rule proposing to consider the applicant country as an eligible exporter of poultry products and a final rule allowing the importation of poultry products from certified establishments in the applicant country. The later has then to certify the establishments satisfying the equivalent sanitary requirements, to list them and to communicate this information to the FSIS. The entire process, from the document review to the certification of eligible establishments is renewed annually.

In order to export poultry products to the US, China applied for initial equivalence determination in April 2004. A first on-site audit was carried out by the FSIS in December 2004. The Final report of the FSIS was delivered in May 2005 and pointed out “a number of deficiencies in some processing and slaughter plants”.³ Two more on-site audits were done in July and August 2005 and the

¹Dispute DS 392. Information on the dispute is available on the WTO Internet site http://wto.org/english/tratop_e/dispu_e/cases_e/ds392_e.htm

²Report of the Panel, para. 2.11.

³Report of the Panel, para. 2.17.

final report of the FSIS delivered in November 2005 proposed to “add China to the list of countries eligible to export processed poultry products to the United States, provided that the poultry products processed in certified establishments in China came from poultry slaughtered in the United States or certified establishments in other countries eligible to export poultry to the United States”.⁴ The equivalence determination for slaughtered poultry in China never ends. In June 2006, the FSIS determined that “China’s inspection system for slaughtered poultry was preliminarily equivalent pending further evaluation through the rulemaking process”.⁵ However Section 733 of the AAA of 2008 and Section 727 of the AAA of 2009 impeding the FSIS to use funds to establish or implement a rule enabling China to export poultry products into the US created a real cul-de-sac for the equivalence determination requested by China.

The claims from China only concern Section 727. This section was accompanied by a Joint Explanatory Statement (JES) in order to explain its purpose. The JES pointed out that the Congress worried about “very serious concerns about contaminated foods from China” and wanted to know if the revision of the Chinese food safety law that took place in February 2009 was sufficient to release these concerns.⁶ China claimed that section 727 was incompatible with Articles 2.2, 2.3, 5.1, 5.2, 5.5, 5.6 and 8 of the SPS Agreement, with Articles I:1 and XI:1 of the GATT 1994 and finally with Article 4.2 of the Agreement on Agriculture. The lines of attack with these claims are therefore that section 727 is an SPS measure that arbitrarily discriminates between Members (Article 2.3 and 5.5 of the SPS Agreement and Article I:1 of the GATT 1994), that is more trade restrictive than necessary (Article 6.6 of the SPS Agreement), that is not scientifically based (Articles 2.2, 5.1, and 5.2 of the SPS Agreement), that implies unjustifiable delay for the import authorization poultry (Article 8 of the SPS Agreement), that consists in a violation of the Most-Favoured Nation (MFN) principle (Article I:1 of the GATT 1994), and that imposes unjustifiable quantitative restrictions on poultry exports from China (Articles 4.2 of the Agreement on Agriculture and XI:1 of the GATT 1994).

This dispute has received little attention.⁷ It cannot be considered as a high-

⁴Report of the Panel, para. 2.18.

⁵Report of the Panel, para. 2.22.

⁶The JES states that “There remain very serious concerns about contaminated foods from China and therefore the bill retains language prohibiting FSIS from using funds to move forward with rules that would allow for the importation of poultry products from China into the U.S. It is noted that China has enacted revisions to its food safety laws. USDA is urged to submit a report to the Committees on the implications of those changes on the safety of imported poultry products from China within one year. The Department is also directed to submit a plan for action to the Committees to guarantee the safety of poultry products from China. Such plan should include the systematic audit of inspection systems, and audits of all poultry and slaughter facilities that China would certify to export to the U.S. The plan also should include the systemic audit of laboratories and other control operations, expanded port-of-entry inspection, and creation of an information sharing program with other major countries importing poultry products from China that have conducted audits and plant inspections among other actions. This plan should be made public on the Food Safety and Inspection Service web site upon its completion”.

⁷For Chen (2010) this dispute was raised by a basic protectionism based on sanitary safety concerns.

profile WTO trade dispute and has raised interest only because China was the complainant and appeared as a newcomer WTO Member defending its markets. Commenting China's accession to the WTO, Fuller et al. (2001) prognosticated that China should not have a comparative advantage in livestock production because of production land scarcity (for feed crops). Phytosanitary problems were also reported as serious potential hindrance to exports. As a matter of fact, in 2010 China's exports of poultry products represent only 4% of the global exports far behind Brazil (35.8%) and the US (35.5%). However, because of a strong internal consumption (15.6% of the global consumption against 19.7% for the US), China is the second world poultry producer, with 15.5% of the total production, behind the US (23.5% of the total production). Both China and the US import few poultry (3.8% and 0.5% of the global imports respectively).⁸

A rapid reading of the dispute would conclude that nothing really new is raised by this case: we could even say that we observe the application of a SPS mechanics into its stride,⁹ as elaborated in previous Panel and Appellate Body (AB) reports dealing with SPS measures in a context where the defendant is totally unable to oppose acceptable arguments to the Chinese claims since Section 727 has no scientific justification. A more critical analysis of the dispute is interesting however for two reasons. First, the 'scientific-based' viewpoint according to which any restrictive SPS measure shall be justified with a specific risk assessment has been defended by the US in past emblematic WTO trade disputes. The *EC - Hormones* case¹⁰ and the *EC - Approval and Marketing of Biotech Products* case¹¹ are good examples. The position of the US on *US - Poultry* case may appear as singular as a consequence. A closer look at the exact justification of section 727 by the US is therefore interesting. Second, once revealed, the exact nature of the US's motive for impeding importations of Chinese poultry products does not correspond to habitual reasons and has not been recognized in this dispute. This reason is distrust that the US expresses with regard to the capacity of China to ensure that the poultry exports are safe. This motive for constraining measures has not been raised in preceding SPS disputes. It differs from the main issue that has been debated as far as there on the possibility to adopt distorting protective measures in situations where scientific evidence on risk is incomplete. Exploring the issue of trust can give an interesting view on SPS disputes and contributes to the discussion of the economic rationales of the SPS Agreement.

The paper is structured as follows. Section 2 develops a presentation of the dispute insisting on the characteristics portraying it as a textbook case. Section 3 presents an economic analysis of the dispute aiming at discussing the motive of mistrust as a justification for SPS measures. Section 4 concludes.

⁸Source: USDA (2011).

⁹See Pauwelyn (1999) for the interpretation of the legal principles of the SPS Agreement in the first SPS dispute.

¹⁰See Charlier and Rainelli (2002) for an analysis.

¹¹See Prévost (2007) for an analysis.

2 The decision of the Panel

The first question the Panel had to answer was to determine if Section 727 can be considered as an SPS measure. The question is important since it determines if the SPS agreement can be considered in order to reach a decision on this case even if others agreements are considered. Following Article 1 of the SPS agreement the Panel investigated first if Section 727 was relevant to the definition of an SPS measures in Annex A(1) of the SPS Agreement and second if it affected the international trade. Section 727 stipulates that “None of the funds made available in this Act may be used to establish or implement a rule allowing poultry products to be imported into the United States from the People’s Republic of China”. Section 727 is an appropriation bill, dealing with the use of funds by an Executive Branch agency of the US and does not directly regulate any SPS issues.¹² It could therefore be considered as something else than an SPS measure as claimed by the US. However, as already pointed out, Section 727 was accompanied with a JES pointing recent food contamination affairs in China as a reason for constraining the use of funds by the FSIS. The aim of protecting human and animal life and health against the risk that poultry products from China would present, i.e. the SPS character of Section 727, inevitably appears as a consequence and was recognised by the Panel.¹³ Finally the fact that section 727 prevented China from exporting Poultry products to the US and could be considered as a consequence as affecting international trade was not challenged by the US. The Panel concluded that the second condition of the definition of an SPS measure given in Article 1 of the SPS Agreement was therefore met.¹⁴

At this stage of the resolution of the dispute, one can already understand on what extent the affair gets off to a bad start for the US. As soon as Section 727 is recognized as an SPS measure, the application of the fundamental obligation to decide any constraining SPS measure on the base of a scientific risk evaluation is going to be required by the Panel following different Panels and the AB on previous SPS disputes. Yet, in front of this requirement, the JES accompanying Section 727 can hardly be considered as a scientific evaluation. In order to avoid this dead end, the US attempted to limit the application of the SPS Agreement to its Article 4 only dealing with equivalence regime.¹⁵ Since China didn’t make any claim on this article, the Panel refused to examine specifically its application¹⁶ and ruled however that Article 4 could not be considered as “a defense against violations of other provisions of the SPS Agreement” according

¹²Report of the Panel, para. 7.107.

¹³Report of the Panel, para. 7.120.

¹⁴Report of the Panel, para. 7.123.

¹⁵The first part of this article asks the exporter to "objectively" demonstrate to the importer that its SPS control system achieves the importer's "appropriate level of SPS protection". The idea to place China on such a position is clearly interesting from the US perspective. However the second part requests Members to "enter into consultation", something that Section 727 impedes. The issue of considering Section 727 as part of an equivalence regime would have been therefore disputable.

¹⁶Report of the Panel, para. 7.132.

to the Panel on *Japan - Apples* case, and was not the only provision in the SPS Agreement that was relevant to Section 727.¹⁷ All the allegations of China could therefore be considered.

2.1 The Panel's finding on China's SPS claims

The first allegation of China is a 'classic' claim in SPS disputes: Section 727 contradicts Articles 2.2, 5.1 and 5.2 of the SPS Agreement since no risk assessment was done to support the need of a trade barrier.¹⁸ Article 2.2 asks that Members shall ensure that any SPS measure is based on scientific principles and is not maintained without sufficient scientific evidence. Article 5.1 asks Members to base their SPS measures on a risk assessment whereas Article 5.2 qualifies what should be intended as a proper risk assessment. The US argues that these articles are not relevant to Section 727 since this Section is "a procedural requirement adopted in the course of an equivalence determination"¹⁹

Following previous rulings of panels and of the AB,²⁰ the Panel considered that Articles 2.2 and 5.1 have to be considered jointly since Article 5.1 can be seen as a particular application of the obligations appearing in Article 2.2. After reminding the principal characteristics of the concept of risk assessment as defined in Annex A(4) of the SPS Agreement and the interpretation it received by Panels and the AB on previous disputes, the Panel considered first if an appropriate risk assessment was presented by the US as required by the Articles 5.1 and 5.2 of the SPS Agreement. As the US indicated that they didn't present any risk assessment,²¹ the Panel turned to Article 2.2 in order to evaluate whether Section 727 was based on scientific evidence (other than a risk assessment) as required by Article 2.2 of the SPS Agreement. Instead of presenting a risk assessment supporting the need of Section 727, the US presented a series of scientific information issued from different sources (international organizations, governmental bodies and academic world) pointing out failures of China's food safety system and food safety crises. Here again following previous panels and the AB on *Japan - Agricultural Products II* and on *Japan - Apples*, the Panel considered that the scientific evidence presented had to "bear a rational relationship to the measure"²² to be considered as 'sufficient' within the meaning of Article 2.2 and had to "demonstrate the existence of the risk which the measure is supposed to address". Since the evidence presented by the US was too general pointing Chinese systemic problems on food safety rather than scientific studies dealing with risk in the Chinese poultry sector, the Panel ruled that it was not dealing specifically with the "risk of consuming unsafe poultry from China"²³ and concluded as a consequence that Section 727 contradicted

¹⁷Report of the Panel, para. 7.139.

¹⁸Report of the Panel, para. 7.162.

¹⁹Report of the Panel, para. 7.166.

²⁰On the *EC - Hormones, Australia - Salmon* and *EC - Approval and Marketing of Biotech Products* cases.

²¹Report of the Panel, para. 7.192.

²²Report of the Panel, para. 7.200.

²³Report of the Panel, para. 7.202.

Articles 2.2, 5.1 and 5.2 of the SPS Agreement.

This gap between the scientific exigencies of the SPS agreement and the arguments presented by the US will be central again on other points of the Panel's decision. The Panel found that Section 727 contradicts Article 5.5 on this ground. This article asks Member to "avoid arbitrary or unjustifiable distinctions in the levels it considers to be appropriate in different situations, if such distinctions result in discrimination or a disguised restriction on international trade".

Following the Panel on *EC – Hormones*, the Panel distinguished three steps in order to show that Section 727 contradicts Article 5.5 as China claimed.²⁴ First, the Panel considered that the importation of poultry products from China and the importation of poultry products from other allowed WTO Members faced the same class of risk (salmonella, campylobacter and listeria contamination) and formed as a consequence "different yet comparable situations".²⁵ Furthermore, the Panel found that Section 727 gives rise to distinction in appropriate level of protections in different yet comparable situations. To reach this conclusion, the Panel agreed with China that Section 727 is "legally distinct from the PPIA" because it concerns only China.²⁶ Under the PPIA importation of poultry is prohibited as long as the exporting country has not demonstrated that its SPS measures achieve appropriate level of protection defined by the PPIA. Comparatively, Section 727 prohibits imports of poultry from China in any case.²⁷ The Panel considered that a risk assessment concluding that poultry from China is more dangerous than poultry from other WTO Members was the only way to defend such a position (even if it agreed with the Panel in *Australia – Salmon* that the determination of the level of protection that a rule is intended to implement is an issue independent from the realization of a risk assessment).²⁸ Second the Panel considered, still following the Panel on *EC - Hormones*, that "not all discrimination in the application of measures is necessarily 'arbitrary or unjustifiable' and it is only the arbitrary or unjustifiable inconsistencies that are to be avoided"²⁹ and examined, as a consequence, whether the US presented justification for discriminating poultry products from China. Because SPS measures must be based on scientific principles and evidence, the Panel argued that a scientific support had to explain the discrimination at stake with Section 727. Since the Panel had already concluded that Section 727 lacked scientific base, pointing out that the information provided by the US on China's food safety enforcement problems and food safety crises cannot be considered as adequate risk assessment, it deduced that this measure arbitrarily discriminated Chinese poultry products. Incidentally, we can appreciate the reduction of the scope given to

²⁴China claimed that two situations are covered by article 5.5: a difference in treatment for Chinese poultry compared to poultry from other WTO Members and a difference in treatment for Chinese poultry compared to other Chinese food products. The panel addressed only the first issue, and exercised 'judicial economy' with respect to the later.

²⁵Report of the Panel, paras. 7.233 to 7.234.

²⁶Report of the Panel, para. 7.243.

²⁷Report of the Panel, para. 7.249.

²⁸Report of the Panel, para. 7.250.

²⁹Report of the Panel, para. 7.261.

the term "arbitrary" to something that it is not scientifically based. Third the Panel concluded that this situation resulted in a discrimination against China.³⁰

The findings on Article 5.5 permitted the Panel to show that Section 727 was also incompatible with Article 2.3 of the SPS Agreement requiring that SPS measures do not arbitrarily discriminate between Members "where identical or similar conditions prevail". The conclusion of the Panel on Article 5.6 is more interesting. China claimed that Section 727 contradicted Article 5.6 that requires that Members' SPS measures "are not more trade-restrictive than required to achieve their appropriate level of sanitary or phytosanitary protection". For China, the usual FSIS approval rules are sufficient to attain this level of protection and are less restrictive than Section 727. The US disagreed pointing out a series of argument among which the idea that China's food crisis created exceptional circumstances usual FSIS approval procedures cannot cope with. Section 727 was therefore defended as a necessity in such a context.³¹

The Panel followed the opinion of the AB on *Australia – Salmon* according to which a violation of Article 5.6 is established if there is a SPS measure which "(1) is reasonably available taking into account technical and economic feasibility; (2) achieves the Member's appropriate level of sanitary or phytosanitary protection; and (3) is significantly less restrictive to trade than the SPS measure contested."³² The Panel noted however that the third criteria needs that the appropriate level of sanitary or phytosanitary protection actually enforced by Section 727 should be compared with the risk of Chinese poultry. Since this risk was unknown to the Panel because the US had not based Section 727 on a risk assessment, the Panel refused to rule on China's claim under Article 5.6.³³

The last article of the SPS Agreement concerned by China's claims was Article 8 asking Members to "observe the provisions of Annex C in the operation of control, inspection and approval procedures". More precisely China claimed that section 727 contradicts Article 8 since it impede the US to meet the requirements under Annex C(1)(a) of the SPS Agreement demanding to Members to ensure that any procedure to ensure conformity with a SPS measure are "undertaken and completed without undue delay". The Panel checked first that the FSIS procedures are "control, inspection or approval procedures" and examined then whether Section 727 implied 'undue delay' in the progress of the FSIS procedures.³⁴ Following the Panel on *EC - Approval and Marketing of Biotech Products*, the Panel understood 'undue delay' as delay that cannot be explained with a 'legitimate justification'.³⁵ Once FSIS procedures were recognized as entering into the field of Annex C(1) of the SPS Agreement, the wording of Section 727 inevitably showed that this section delayed the normal progress of the FSIS procedures. Once again the Panel deduced that this delay had no legitimate justification from the fact that no risk assessment justifies Section

³⁰ Report of the Panel, para. 7.294.

³¹ Report of the Panel, para. 7.329.

³² Report of the Panel, para. 7.331.

³³ Report of the Panel, paras. 7.335 to 7.337.

³⁴ Report of the Panel, para. 7.356.

³⁵ Report of the Panel, para. 7.386.

727,³⁶ blowing away the US argumentation pointing out China's sanitary crisis in food sector and the regulation enforcement problems this country faces.³⁷

2.2 The Panel's finding on China's GATT 1994 claims

China claimed that Section 727 was incompatible with Articles I:1 and XI:1 of the GATT 1994. The allegation on Article I:1 is especially important since it concerns the Most-Favoured Nation clause (MFN), a core principle of the GATT. MFN prevents Members from discriminating³⁸ among imported alike products on the basis of their national origin. It concerns both border measures such as tariffs and domestic regulations affecting trade. China claimed that Section 727 impedes it to implement the FSIS procedures required to be authorized to export poultry products to the US, a possibility however offered to all other WTO Members. Section 727 would contradict therefore the MFN principle according to which "any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties". The answer of the US is twofold. First, the US pointed out that the difference in treatment that appears in its 'equivalency-based food-safety regime' is necessary as long as Chinese poultry products are not found equivalent to poultry products imported in the US. Second, the US alleged that the Panel should not consider Article I:1 since the basic question is to know whether Section 727 can be justified by "legitimate concerns with human and animal life and health".³⁹

The Panel first considered that Section 727 was "in connection with" importation and was subject, as a consequence, to the Article I:1 of the GATT 1994.⁴⁰ It then found that Section 727 impedes China to export poultry products to the US since this section has the effect to block any equivalence procedures. This possibility to implement FSIS procedures in order to export poultry products to the US is however open to other Members. Discrimination among like products based on the products' origin would therefore be at stake with Section 727, contradicting MFN principle. The only way for the US to defend Section 727 was to claim that the hypothesis of likeness was not verified with Chinese poultry products because of the deficiencies of the Chinese sanitary security system.⁴¹ The discrimination for the US is not based origin but on differences of safety. This argument however was not supported by a risk assessment. This places the Panel in a position to consider poultry products from China and from other Members as "hypothetical like products" and to and conclude that the discrimination implied by Section 727 was based on the product origin only. Proceeding with the "hypothetical like products" analysis in order to show that Section 727

³⁶Report of the Panel, para. 7.391.

³⁷Report of the Panel, para. 7.388.

³⁸For a presentation of non-discrimination in WTO Agreements see Horn and Mavroidis (2009).

³⁹Report of the Panel, para. 7.398.

⁴⁰Report of the Panel, para. 7.410.

⁴¹Report of the Panel, para. 7.421.

is inconsistent with Article I:1 of the GATT 1994 permits to the Panel to avoid a direct interpretation of likeness on the 'risk-based' logic of the SPS Agreement. This reference however, indirectly and inevitably appears in the Panel arguments. This will be made explicit when dealing with Article XX(b) of the GATT 1994.

The US defended that the only article of the GATT 1994 Agreement relevant in the dispute was Article XX(b). This article forms a derogation of the rule of free trade. It allows taking constraining measures in order to "protect human, animal or plant life or health". For the US, Section 727 was precisely enacted in order to face the risk inherent with the importation of poultry product from China. The Panel reminded that the preamble of the SPS Agreement stipulates that the aim of this Agreement is to "elaborate rules for the application of the provisions of GATT 1994 which relate to the use of sanitary or phytosanitary measures, in particular the provisions of Article XX(b)".⁴² Hence, without claiming that "any analysis of Article XX(b) must be done with reference to the SPS Agreement",⁴³ the Panel decided that, because Section 727 was found inconsistent with Articles 2 and 5 of the SPS Agreement, reference to Article XX(b) cannot be made in order to justify this constraining measure.

3 An economic analysis of the *US – Poultry* dispute

In this section an economic analysis of the *US – Poultry* case is developed in order to stress the importance of trust in the dispute. This motive implicitly appears in the US's allegations and is ignored (because not well established) by the Panel. Taking account of trust gives as a result another perspective on the dispute. In the continuation of this analysis an analysis of MFN pointing out the importance of reciprocity is finally given.

3.1 The problem of trust

The presentation of the *US – Poultry* case from a legal perspective clearly shows that the main line of argument of the Panel was to examine whether Section 727 was established on a risk assessment or not. More precisely, an evaluation of the risk presented by Chinese poultry products concluding that these products are dangerous was required in order to justify Section 727. In front of this claim, the US only opposed general studies and information pointing out that China faces serious sanitary problems and difficulties to contain corruption and to control local authorities. Obviously these arguments cannot be considered as a risk assessment and do not specifically consider Chinese poultry products. They show however that the US considered that the Chinese sanitary safety system's reliability is weak and that the US didn't trust it, refusing (with Section 727)

⁴²Report of the Panel, para. 7.470.

⁴³Report of the Panel, para. 7.482.

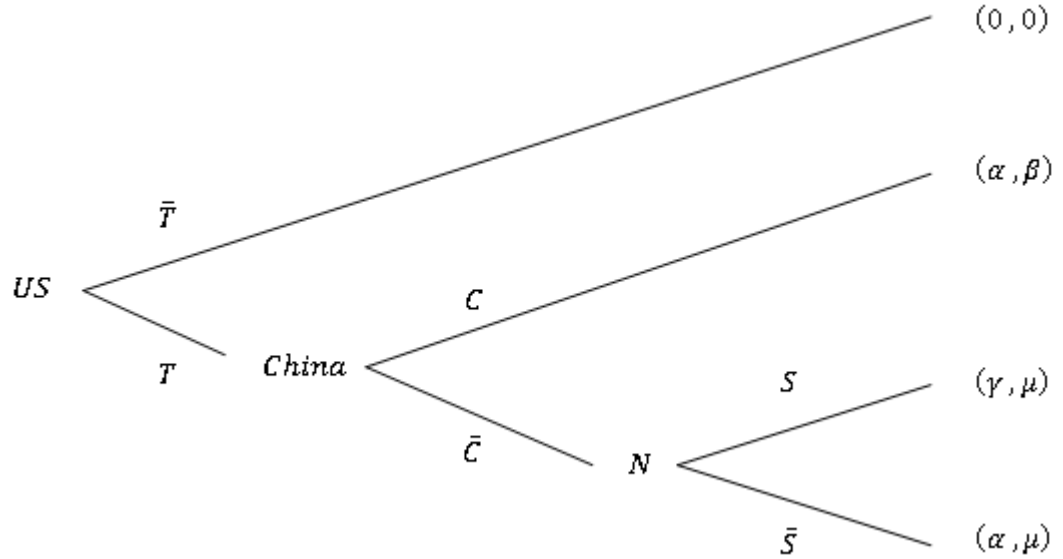
Chinese poultry product as a consequence. The issue of trust appearing in the US defense is never brought to light in the Panel's analysis of the case who invariably pointed out the need for a risk assessment centered on Chinese poultry products. This dialogue of the deaf is transversal to the entire Panel's report. We believe that the originality of this case is here. Can mistrust in the capacity of China for correctly implement the required safety system be easily reduced to a problem of risk presented by Chinese poultry products? If not, can we expect a different interpretation of the case (and even different conclusions) than the one given by the Panel in its report? In order to discuss these issues the dispute is interpreted from an economic perspective using basic game theory.

3.1.1 Two variations of a trust game as two different views on the US - Poultry case

The possibility of exchange is represented in a game theoretic framework where the US and China plays sequentially. In this stylized representation, the absence of trade yields 0 for both countries. This situation is considered as a status quo ante situation. Consequently international trade is accepted if it yields positive payments for both countries. On the contrary, a protective measure is allowed if trade leads to a negative payment (a player refuses to exchange). Such measure is condemned otherwise. In a first step, the US decides to allow (or not) poultry products imports from China. If the US doesn't trust China (as with Section 727) the game ends and both countries earn 0. If the US trusts China, believing that Chinese authority will succeed in implementing proper sanitary measures, China has then to choose between investing in sanitary control or not. Two variations of this game can be given in order to illustrate the divergence between the US and the panel on the ways of seeing the context of the dispute. Both variations are in keeping with the general framework used by Dasgupta (2000) in order to study trust in economic transactions.

The first variation of the trust game is constructed with the aim of illustrating what we could call the Panel's view on the US – Poultry dispute. A tree representation of this game is given in *figure 1*:

Figure 1: The panel's variation of the trust game



We suppose here that when China invests no sanitary problem can appear and the US and China gain respectively $\alpha > 0$ and $\beta > 0$.⁴⁴ When China does not invest a sanitary problem can arise with probability $(1 - q)$. In that case, the US and China gain respectively $\gamma < 0$ and $\mu > \beta$. The payment of the US is supposed to be negative because of the sanitary problem.⁴⁵ The payment of China is supposed to be lower when the sanitary control is implemented because of the cost supported in that case. This assumption creates an interesting situation. Under this assumption China is indeed incited to avoid sanitary control (the US's concern in the dispute) when trade is allowed. This does not mean that China would have done this if the US had decided to allow trade. In the game, this assumption places the US in a situation where the risk caused by Chinese poultry products has to be demonstrated, as required by the Panel: if the US is convinced that China avoids controlling its poultry products, the US has to demonstrate that the exchange brings a negative payment so that impeding trade is preferred (and justified). In other words, the US has to demonstrate that its expected payment is negative:

$$p\alpha + (1 - p)\gamma < 0 \quad (1)$$

For that, and with $\alpha > 0$, the US has therefore to show that the probability that Chinese poultry products are unsafe is sufficiently high:

⁴⁴This assumption that no risk appears following Chinese investment is clearly simplistic. A proper investment in sanitary control should ideally permit a level of risk acceptable from the US point of view.

⁴⁵If it was positive, no justification for a measure constraining trade would be justifiable.

$$(1 - p) > \frac{\alpha}{\alpha - \gamma} \quad (2)$$

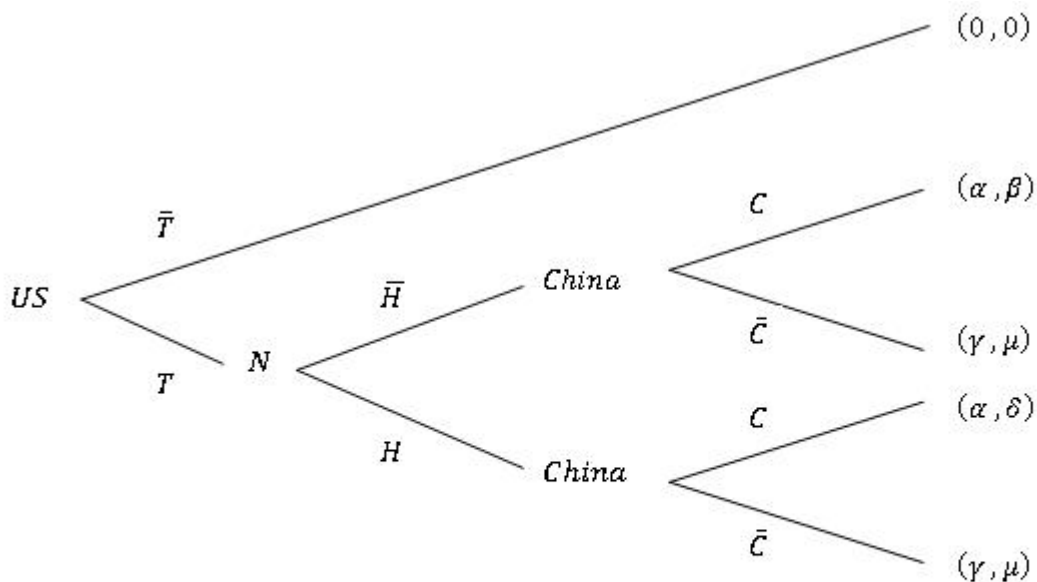
In that case, a backward reasoning leads to the conclusion that the US can legitimately decide not to trust China and impedes poultry imports from this country. If however for given $\alpha > 0$ and γ , the value of p is such that condition (2) is not respected (the US expected payment is positive), prohibiting Chinese poultry products imports could not be justified.

This variation of the trust game stresses one particular element very important in the Panel's reasoning: a risk assessment has to be done in order to legitimate a constraining measure for international trade.⁴⁶ In this view, the probability p and therefore the risk assessment concern the occurrence of a sanitary problem (the event S) directly affecting the sanitary quality of the Chinese poultry products. This variation of the trust game illustrates well therefore the Panel's attention paid to the risk assessment specifically addressing Chinese poultry. Note that the idea of trust is not very important in this framework. Williamson (1993) speaks about "calculative trust" in such contexts where what matters is a question of risk: being aware of the possible outcomes and their attached probabilities and entering into exchange only if the expected net gain is positive. In this view, trust appears therefore as a useless concept. This of course gives weight to the Panel's decision focalized on risk.

The second variation of the trust game is constructed with the aim of illustrating the US's view on the *US - Poultry* dispute where trust is more well-founded. A tree representation of this game is given in *figure 2*.

⁴⁶The representation inevitably conceives risk assessment as a quantitative evaluation of the probability p of a sanitary accident. This is clearly simplistic since the SPS exigencies are not so demanding when 'food-borne' risk are at stake. The Appellate Body on the *EC - Hormones* case, stressed that such a quantitative requirement for the risk assessment finds no basis in the SPS Agreement (see Charlier and Rainelli 2002). This idea has been reminded in the judgment of various SPS disputes since this first one.

Figure 2: The US's variation of the trust game



Following Harsanyi (1967) a fictional move by nature (N) is introduced in step 2 in order to describe a game of incomplete information as a game of imperfect information. This move reveals China's type to China only.

As in the first variation the US has to decide whether allowing or not imports of poultry products from China. If the US doesn't trust China the game ends and payments corresponding to the status quo are realized. If the US trusts China an exogenous hazard becomes relevant for the US (the nature's move): China is politically and administratively able to implement effective sanitary control with a probability q . This hazard represents the US questioning appearing in the dispute on the effectiveness of the revision in Chinese food safety laws and regulations in front of the evidence of severe failures. This hazard does not directly concern the Chinese's control decision, neither poultry products' risk, but addresses China's ability to enforce its safety regulation. Two possibilities appear therefore (China's type is E or \bar{E}) and in both cases China has to choose between controlling or not. We suppose that when China controls, the gain of

the US is equal to α . When it does not, the US's payment is γ .⁴⁷ Whatever its type (i.e. able or not to enforce its safety regulation), China receives μ when it does not control. However, its payment associated with controlling depends on the capacity to enforce safety regulation: when China's type is \bar{E} (not able to correctly enforce its safety regulation) the payment of controlling is β whereas when its type is E (able to correctly enforce its safety regulation) the payment of controlling is δ .

An important feature of this game is that: $\delta > \mu > \beta$. In this assumption, $\mu > \beta$ for the reason of cost saving pointed out in the first variation of the game and $\delta > \beta$ because sanitary controls are supposed to be easier when China is able to enforce its safety regulation. It is supposed furthermore that $\delta > \mu$: When China can enforce its safety regulation, controlling is more profitable than not controlling. A simple interpretation of this assumption is that controlling when efforts have been spent in order to be able to enforce safety regulations yields a reputation gain.

This assumption generates an interesting situation. If China is of type \bar{E} (this eventuality happens with a probability $(1 - q)$), it doesn't choose to control (since $\mu > \beta$). If China is of type E (this happens with a probability q), it chooses to control (since $\delta > \mu$). Using backward reasoning, the US knows therefore that the expected payment of choosing to allow imports of Chinese poultry products is $q\alpha + (1 - q)\gamma$. In order to justify a refusal to import Chinese poultry products the US has therefore to demonstrate that this expected payoff is negative or that the probability $(1 - q)$ that China is not able to correctly enforce its safety regulation is high enough:⁴⁸

$$1 - q > \frac{\alpha}{\alpha - \gamma} \quad (3)$$

The perspective given by the second variation of the trust game is therefore different from the first variation's one. The risk assessment centered on the probability q in the second variation should take into account elements enabling to qualify the capacity of China to enforce its safety regulation. The risk of Chinese poultry products is not directly at stake in this risk assessment contrary to what is required in the Panel's variation of the trust game.

3.1.2 Discussion

Our interpretation of the *US - Poultry* case, using two game trees, underlines that the panel got a very limitative view of the dispute. Asking for risk assessment on the risk presented by Chinese poultry products only ignores two linked characteristics of this dispute. First, a problem of trust is at stake as far as the US's expressed fears are considered. Second, these fears primarily concern systemic deficiencies of the Chinese sanitary control system rather than the poultry products themselves. The consequence of the second characteristic

⁴⁷For simplicity we do not consider that a sanitary problem can appear with probability p as a second hazard when China does not control (as in the first variation of the trust game). This could be done but would not change our interpretation.

⁴⁸Or equivalently $q < \frac{\gamma}{\gamma - \alpha}$.

is straightforward: asking for a risk assessment limited to the poultry products is not enough. This one should be completed with a risk assessment focusing on the systemic failures put forward in the US's claims and on the description of the ways these failures can affect the safety of the poultry products.⁴⁹

The consequence of the first characteristic is that the Panel ignores an important idea according to which trust is seen as permitting trade or making it easier. This idea forms a point of departure of an important economic literature. In a situation of asymmetric information between the seller and the buyer, trust is seen as cement for exchange. In the *figure 2* for example, if the US trusted China believing that it is of type H (i.e. believe that China will honor its engagement to control the implementation of the US sanitary requirements), it would have no reason to impede imports of Chinese poultry products. If the US didn't trust China because $q < \frac{\gamma}{\gamma-\alpha}$, it should be ready to invest a positive amount in order to discriminate between the two types H and \bar{H} . Refusing to invest in such a situation will bring the statute quo and a payment of zero for the US. Investing, it could discover that China is of type H and gain α within the exchange that would take place in such a situation. Note that China is in a comparable situation. When exchange takes place a type H gains δ (choosing C) while a type \bar{H} gains μ (choosing \bar{C}). As a consequence, when China is able to implement its safety regulation (type H) it should be ready to pay up to δ to establish the reputation of fulfilling the US's sanitary requirements (i.e. $q > \frac{\gamma}{\gamma-\alpha}$), while when it is not able (type \bar{H}) it should be ready to pay up to μ to establish the same reputation. As $\delta > \mu$, establishing this reputation has more value for China when controlling the implementation of the sanitary regulation is possible.

This discussion highlights the *US - Poultry* case from a different perspective. In particular, the idea that the US should be ready to invest in order to verify that $q \geq \frac{\gamma}{\gamma-\alpha}$ can be interpreted. The FSIS procedures can effectively be considered as the concrete expression of the US's attempt to discover if $q \geq \frac{\gamma}{\gamma-\alpha}$. The decision to impede the normal course of these procedures with Section 727 is difficult to explain as a consequence. A first explanation could be that the US believes that $q \geq \frac{\gamma}{\gamma-\alpha}$ and considers consequently that investing in FSIS procedures is useless. In this case, Section 727 would be a basic protectionist measure. A second explanation could be that the US has the prior belief that $q < \frac{\gamma}{\gamma-\alpha}$. In that case FSIS procedure can refine this belief and Section 727 has no economic rationale as a result. The only way to justify Section 727 in such a situation would be to demonstrate that the usual FSIS procedures are unable to deal with the exceptional circumstances presented by the Chinese poultry industry (i.e. unable to bring information on the ability of China to control the implementation of its sanitary regulation). The JES accompanying Section 727 cannot obviously be considered as such a demonstration. The US's position is therefore contradictory. Note that in order to reach this conclusion no reference has been made to the requirements of the SPS Agreement. The FSIS procedures and Section 727 are considered in light of the equivalence regime framework as

⁴⁹Note that neither of these assessments has been furnished by the US in the dispute.

unsuccessfully asked by the US.

Is the interpretation given with the second variation of the trust game acceptable from the SPS Agreement point of view? An important feature of this interpretation is that risk assessment should specifically take into account the implementation conditions of the poultry safety regulations. If the connection between this 'institutional risk' and the risk presented by poultry products was not clearly established, such an interpretation of the risk assessment would be rejected by a Panel. The kind of risk assessment to be conducted is defined in Annex A.⁵⁰ This definition of a proper risk assessment is clearly centred on the products only. This impression is reinforced by the list of the specific factors to be taken into account in a risk assessment summed-up in Article 5.2 of the SPS Agreement.⁵¹ However, the AB on *EC – Hormones* found that:

there is nothing to indicate that the listing of factors that may be taken into account in a risk assessment of Article 5.2 was intended to be a closed list. It is important to bear in mind that the risk that is to be evaluated in a risk assessment under Article 5.1 is not only risk ascertainable in a science laboratory operating under strictly control conditions, but also risk in human societies as they actually exist, in other words, the actual potential for adverse effects on human health in the real world where people live and work and die.⁵²

What is exactly intended with "risk in human society" is not defined. Neither are the other factors that could be considered in a risk assessment as a result. However, this finding of the AB lets open the door to the interpretation given with the second variation of the trust game.

3.2 The MFN treatment

MFN is, with National Treatment provision (Article III of the GATT 1994 Agreement), a primary nondiscrimination principle. It impedes Members to discriminate among *like* products coming from distinct other Members. It appears in Article I of the GATT 1994 Agreement and on GATS, TBT and TRIPS Agreements but not on SPS Agreement. Its wording exhibits a "multiplier effect" (Jackson 1997): any bilateral liberalizing trade policy has to be extended to any third party as soon as the products are alike. *Likeness* of product is therefore a central issue when interpreting MFN in a dispute. The view express

⁵⁰Risk assessment is defined as "The evaluation of the likelihood of entry, establishment or spread of a pest or disease within the territory of an importing Member according to the sanitary or phytosanitary measures which might be applied, and of the associated potential biological and economic consequences; or the evaluation of the potential for adverse effects on human or animal health arising from the presence of additives, contaminants, toxins or disease-causing organisms in food, beverages or feedstuffs". See Pauwelyn (1999) for a discussion.

⁵¹Article 5.2 reads "In the assessment of risks, Members shall take into account available scientific evidence; relevant processes and production methods; relevant inspection, sampling and testing methods; prevalence of specific diseases or pests; existence of pest- or disease-free areas; relevant ecological and environmental conditions; and quarantine or other treatment".

⁵²*EC – Hormones*, Appellate Body Report, para. 187.

on likeness are different depending on the type of dispute. The survey of Horn and Mavroidis (2001) shows that likeness is usually understood using the classification of products provided with the Harmonized System when border measures such as tariffs are concerned, or using market test such as 'consumers reactions' or 'cross-price elasticity' when domestic measures are at stake. A tariff classification defining similar goods for customs purposes or economic rationales are therefore used to define like products. The analysis of the Panel's findings developed in section 2 showed that the Panel proceeded with the 'hypothetical like product' analysis on *US – Poultry* avoiding a direct interpretation of likeness on the risk presented by poultry products. However the Panel did this because the US was unable to furnish a risk assessment showing, as it claimed, that the risk level of the poultry products was different. Contradicting the US claim drove therefore the Panel to give an interpretation of likeness in some way rooted in a SPS 'scientific-based' logic. This logic was therefore substituted to the broader economic rationale of the market test. Once likeness was recognized, Section 727 was found to impose origin-based discrimination since it enforces origin-based restriction. This restriction removes the opportunity to access the US's market and was therefore considered as prejudicial.

In what follows we try to give another interpretation of a prejudicial discrimination in this dispute derived from the economic framework used with the trust game. Before developing it, two interpretative points can be underlined. First, we can note that when trust is recognized as a major issue in a dispute, tackling the MFN question is not straightforward. Trust is often conceived as embedded in bilateral relations.⁵³ Being specific to two parties, it is difficult, as a consequence, to regard the possibility to extend trust that a party can have on the other one (and consequently on its products) to the products of a third party following MFN. Second, considering likeness on the ground of the compared risk levels of the poultry products entering FSIS procedures is rather surprising. An equivalence regime should be able to consider products with different risk levels and ascertains that at the exit of the procedures every product allowed meets a minimum safety standard. The "hypothetical like products" assumption could have been made because Chinese poultry products have to meet the requirement of the FSIS procedures like other poultry products from any other Members seeking to export to the US.

We consider three countries *A*, *B* and *C*. *A* imports poultry products whereas the two other *B* and *C* are potential exporters. *A* implements equivalence procedures before allowing imports. Whatever the compared risk of the poultry products exported by *B* and *C*, impeding the implementation of the equivalence procedures with one of the exporters (*C* for example) creates an asymmetry between the two countries. This first conclusion cannot allow concluding in discrimination. Such a conclusion needs to go further to be reached. Maintaining the equivalence procedures with *B* can eventually permit to verify that $q \geq \frac{\gamma}{\gamma-\alpha}$ and to allow imports from this country as a consequence. In this case,

⁵³See for example James (2002) in a game theory setting or Cox (2004) in experimental economics.

both parties A and B have invested in the creation of a trading relation through the implementation of the equivalence regime required by A . Importantly, in this realization, the investment of the importing country A is the counterpart of the investment of the exporting country B . Impeding the equivalence procedures with C breaks this possibility. If C still invests (as B) in the control of the sanitary security of its poultry industry with the aim of being able in the future to export to A , this investment has no counterpart. C 's investment nevertheless participates to the creation of a future trade that benefits to A . C is therefore responsible for a positive externality on A . Impeding the equivalence procedures with C blocks reciprocity and allows A taking advantage of this relation. This cannot be done with B , with whom reciprocity is expressed. The asymmetry between B and C is therefore discriminating.

Is this discrimination defensible? Since A 's investment in its equivalence regime implementation with B creates a reciprocity, a way to defend a break in this investment with C would be to demonstrate that A 's investment does not create reciprocity with the later and is useless as a result. This can be done demonstrating that A 's equivalence regime cannot handle the specificity of C 's food safety system. This feature has already been put forward in the interpretation of *US – Poultry* case considering SPS claims. It therefore finds new rationale with the economic interpretation of MFN. Note that the difference in safety between products is useless to reach this conclusion. The economic rationale of the discrimination is found in the idea that investment in sanitary control of one exporting country creates a positive externality on A whereas the same investment of the other exporting country is internalized in the equivalence procedures with an investment of A in counterpart.

4 Conclusion

This paper discusses the *US – Poultry* case from an economic perspective. The first part of the paper presents an analysis of the Panel's decision. It shows that the absence of risk assessment pointing out the risk of Chinese poultry products is systematically pointed out by the Panel in order to show that Section 727 is incompatible with various articles of the SPS agreement. This reasoning is in line with precedent decisions in SPS cases. Its invariability however impeded the Panel to fully appreciate the exact nature of the defense presented by the US pointing out a lack of trust due to the deficiencies of the Chinese sanitary security system. The second part of the paper presents an economic analysis of the dispute. For this purpose, the concern of trust expressed by the US is placed at the center of the reasoning. In this analysis, the *US – Poultry* case is described with the help of game theory. Trust is considered in an asymmetrical relationship between two parties: the first party (the US) has to choose to enter an economic relationship (accept Chinese poultry products) without knowing whether the second party (China) will honor his part of the relationship (correctly implement the US's sanitary requirements). This interpretation points out that Section 727 could have been considered as legitimate if the US had

demonstrated (something that it did not) that the sanitary requirements used with other poultry exporting WTO Members cannot be correctly implemented by China because of systemic failures in the control of the implementation of its sanitary regulation. This conclusion is reinforced by the analysis of MFN where the concept of reciprocity is put forward.

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