

## **The International Law Gaze: *Indonesia – Import Licences Regimes (New Zealand)***

**Alberto Alvarez-Jimenez, University of Waikato, on a big win for New Zealand at the WTO**

The results in inter-State litigation seldom permit comparisons with competitive sports. A rare exception is the panel report of the World Trade Organization (WTO) in *Indonesia – Importation of Horticultural Products, Animals and Animal Products [Indonesia – Import Licences Regimes]*. The score at the first stage of this litigation is New Zealand 18 – Indonesia 0. New Zealand and the United States, separately, challenged 18 of Indonesia's import restrictions adopted since 2011, which were aimed at protecting the local beef and horticultural industries (the measures), and the panel declared that all of them were contrary to the law of the WTO. New Zealand's like industries may see the end of their problems in Indonesia on the horizon. The win, though, is not definitive, since the latter has appealed the report before the WTO Appellate Body. (World Trade Organization, *Notification of an Appeal by Indonesia under Article 16.4 and Article 17 of the Understanding on Rules and Procedures Governing the Settlement of Disputes*, 21 February 2017).

### **The Trade Impact and the Legal Basis of the Dispute**

According to the Ministry of Foreign Affairs and Trade (MFAT), the adverse trade impact of the import restrictions on New Zealand's beef and horticultural products was between 0.5 and 1 billion dollars, and the reduction in volume of exports was 80% since the measures had been adopted. (Ministry of Foreign Affairs and Trade, *Current Disputes*. <https://www.mfat.govt.nz/en/trade/trade-law-and-dispute-settlement/current-disputes/>). Indonesia argued that the purpose of the measures was to ensure food security and sovereignty, not minor goals and often invoked by States in all continents. (*Indonesia – Import Licences Regimes* at [2.4] & [2.7]). However, New Zealand claimed that the import

restrictions constituted violation of Article XI.1 of the General Agreement on Tariffs and Trade [GATT 1994]. This provision sets forth:

Article XI: General Elimination of Quantitative Restrictions

1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party

The reason for the existence of this prohibition is to induce WTO members to protect their industries with tariffs and not with quantitative restrictions: “A basic principle of the GATT system is that tariffs are the preferred and acceptable form of protection ... The prohibition against quantitative restrictions is a reflection that tariffs are GATT’s border protection ‘of choice.’” (WTO Panel Report, *Turkey – Restrictions on Imports of Textile and Clothing Products* at [9.63]).

The purpose of Article XI.1 is to make international trade much more transparent. Duties and charges are generally easy to determine, and exporters know how much they have to pay to export to a given foreign market. On the contrary, quantitative restrictions create uncertainties for exporters. (Legal and Economic Principles of World Trade Law, Henrik Horn and Petros C. Mavroidis (eds), 2014 at 123 & 143). There are some exceptions to this prohibition, provided for in other parts of Article XI; only one of them is relevant to this case and will be briefly mentioned below.

**The Interpretation of GATT Article XI by the Panel**

The panel started its analysis by defining the legal test for the application of Article XI.1, based on the Appellate Body's and other panels' reports. The test had two steps: (a) the measure in question falls under Article XI.1; and if so (b) the measure constituted a prohibition or a restriction on importation or exportation. (*Indonesia – Import Licences Regimes* at [7.40]). For the sake of brevity, and given that the panel regarded that all of the measures met the first step, this piece will concentrate on the second step. In this regard, the panel, following the Appellate Body, stated that “only those prohibitions and restrictions that limit the quantity or amount of a product being imported (or exported) would fall within the scope of [Article XI.1].” (*Indonesia – Import Licences Regimes* at [7.44]).

The panel then expanded on the limiting effect of imports, and stated, also on the basis of past WTO panel reports, that such effect took place whenever the measures limited the competitive opportunities of imported products. Going even further, the panel pointed out that among those measures were those that introduced uncertainties affecting importation, made imports highly expensive or unpredictable, or granted authorities unlimited or undefined discretion to reject importing licences. (*Indonesia – Import Licences Regimes* at [7.46]). Finally, the panel expressed that a violation of Article XI.1 did not require evidence of the adverse trade effect in the form of quantification of reduction of imports, and that the limitation imposed by a measure could be proven through its design, architecture, and structure. (*Indonesia – Import Licences Regimes* at [7.47]-[7.50]).

### **The Panel's Analysis of the Measures**

The first set of measures adopted by Indonesia provided for a limited application window to get licences to import horticultural products and certain animal products, such as beef. ((*Indonesia – Import Licences Regimes* at [7.77] & [7.314])). The panel developed hypothetical models and found that as a result of the operation of the measures there would be periods of time in which importation

of horticultural and beef products to Indonesia would not take place. (*Indonesia – Import Licences Regimes* at [7.81] – [7.86] & [7.318] – [7.323]). The conclusion was supported by New Zealand’s evidence of exports to Indonesia. (*Indonesia – Import Licences Regimes* at [7.88]). On these bases, the panel determined that these measures limited the competitive opportunities of importers and were, therefore, contrary to GATT Article XI.1. (*Indonesia – Import Licences Regimes* at [7.91] & [7.326]).

The second measure set forth the declaration that terms of approval of imports could not be changed in terms of the type of horticultural products, the quantity, the country of origin, and the Indonesian port of entry. Lack of compliance could lead to the destruction of the products or to their re-export at the importers’ costs. (*Indonesia – Import Licences Regimes* at [7.105]). The panel found that this measure operated as an import quota, because the approved quantity could not be changed; and that the measure introduced inflexibility to the importation process of horticultural products, because importers were not able to react to market conditions. (*Indonesia – Import Licences Regimes* at [7.109] – [7.110]). For these reasons, the panel concluded, the measure limited imports of the said products. (*Indonesia – Import Licences Regimes* at [7.111]). A similar strict measure was adopted regarding the import of animal and animal products, and the panel, for similar reasons, arrived at the identical conclusion. (*Indonesia – Import Licences Regimes* at [7.341] – [3.347]).

The third measure established that the importation of horticultural products could not take place within certain periods prior to, during, and after the harvesting season of the same Indonesian products. (*Indonesia – Import Licences Regimes* at [7.148]). The panel, relying on adverse trade effects proven by the United States, concluded that there was no room for competition when the imported products could not enter the Indonesian market at certain times. As a result, the measure was contrary to Article XI.1. (*Indonesia – Import Licences Regimes* at [7.151] & [7.155]).

The fourth set of measures that applied to both horticultural and beef products required importers to own storage facilities to hold the quantities that they had requested in the import applications. As a result, importers could not import volumes that they could not store in their own facilities, even if they could rent additional facilities to store additional imports. (*Indonesia – Import Licences Regimes* at [7.175]). The panel stated that the measure “explicitly limits the volume of imports of horticultural products by a given importer to the maximum amount that the importer can store in its own facilities.” (*Indonesia – Import Licences Regimes* at [7.175]). On this main basis, the panel concluded that this measure was contrary to Article XI.1. (*Indonesia – Import Licences Regimes* at [7.179]).

The fifth measure established reference prices for chillies and fresh shallots. Importation was suspended once the market price fell below the reference price and resumed once the former exceeded the latter. The Indonesia Ministry of Trade set the prices after taking into account farmers’ operational costs and their profit margins and a reasonable price for domestic consumers. The reference prices could be evaluated at any time and were not published. Imports were suspended even if the price of imported products was above the reference price. (*Indonesia – Import Licences Regimes* at [7.214] – [219]). The panel stated that this measure operated as a temporary ban and, therefore, was contrary to Article XI.1. (*Indonesia – Import Licences Regimes* at [7.221]). The panel went further. It stated that the measure was trade restrictive even when it was not operating, for it “creates uncertainties and incentives for importers to limit the quantities they import.” (*Indonesia – Import Licences Regimes* at [7.222]). A similar price reference system was put in place for beef, with an identical operation. (*Indonesia – Import Licences Regimes* at [7.444]), and the panel declared the system to be contrary to Article XI.1 for the same reasons. (*Indonesia – Import Licences Regimes* at [7.446] – [7.451]).

The sixth measure was the requirement that all imported horticultural products be harvested less than six months before importation. (*Indonesia – Import Licences Regimes* at [7.238]). The panel did not have trouble in concluding that the measure was an import ban that contravened Article XI.1, for those products that had been harvested more than six months ago could not be imported to Indonesia. (*Indonesia – Import Licences Regimes* at [7.241]).

The seventh measure contained a domestic purchase requirement of beef for importers of large ruminant meats. (*Indonesia – Import Licences Regimes* at [7.419]). The panel found that the effect of the requirement was to substitute imported products with domestic products, thereby limiting imports. As a result, this measure was contrary to Article XI.1. as well. (*Indonesia – Import Licences Regimes* at [7.426] – [7.428]).

The eighth measure established that importation of animal and animal products and horticultural products depended on Indonesia's determination of the lack of domestic supply to absorb local demand. (*Indonesia – Import Licences Regimes* at [7.494]). The panel found easily that this measure limited imports. The panel also noted that this measure also created uncertainties for importers regarding when imports would be authorized or banned. (*Indonesia – Import Licences Regimes* at [7.496] – [7.499]).

Finally, New Zealand also claimed that not only each individual measure, but also the entire Indonesian licencing regime for the importation of horticultural products and animal and animal products were contrary to Article XI. (*Indonesia – Import Licences Regimes* at [7.244] & [7.453]). The panel agreed on the ground that the measures interacted with each other and exacerbated the limiting effects on imports. (*Indonesia – Import Licences Regimes* at [7.269] & [7.476]).

After all of these determinations, and in an attempt to counteract any potential criticisms based on an apparent excessive promotion of international trade, the panel did find it important to highlight that “[WTO] members are free to pursue food and farm development objectives as they deem appropriate, provided they are not implemented through WTO inconsistent measures.” (*Indonesia – Import Licences Regimes* at [7.500]).

### **Indonesia’s Defences and the Panel’s Decisions**

In addition to challenging the claims of violation made by New Zealand, Indonesia raised several defences.

First, Indonesia argued that some of the measures were the result of private actors’ actions and not measures maintained by Indonesia as a WTO member; therefore, they were beyond the jurisdiction of the WTO dispute settlement system. (*Indonesia – Import Licences Regimes* at [7.4]). The panel responded by quoting the Appellate Body: “Where private actors are induced or encouraged to take certain decisions because of the incentives created by the measure, those decisions are not ‘independent’ of that measure.” (*Indonesia – Import Licences Regimes* at [7.11]). Then, the panel concluded that, for the purpose of the panel’s jurisdiction, the measures were taken by Indonesia. (*Indonesia – Import Licences Regimes* at [7.12], [7.17], [7.21], and [7.25]).

Second, regarding harvest period requirements and the reference prices for chillies, shallots, and beef, Indonesia invoked Article XI.2(c) of the GATT, which is an exception to Article XI.1. (*Indonesia – Import Licences Regimes* at [7.58]). The former provision sets forth: “2. The provisions of paragraph 1 of this Article [XI] shall not extend to the following: ... (c) Import restrictions on any agricultural or

fisheries product, imported in any form, necessary to the enforcement of governmental measures which operate: ... (ii) to remove a temporary surplus of the like domestic product ... ; ...”

Endorsing New Zealand’s argument, the panel rejected this defence. According to the panel, Article XI.2(c) became inoperative regarding agricultural measures by virtue of Article 4.2 of the WTO Agreement on Agriculture, which basically ordered Members to convert quantitative restrictions on agricultural products into customs duties. (*Indonesia – Import Licences Regimes* at [7.60]).

Third, a finding of a violation of a GATT provision, like Article XI.1, is not the end of the matter, since the GATT provides for a set of exceptions aimed at allowing WTO members to achieve non-trade goals. The relevant exceptions in this case raised by Indonesia were GATT Articles XX(a), (b), and (d). They provide as follows:

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

(a) necessary to protect public morals;

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

(d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, ... and the prevention of deceptive practices;



The Appellate Body has stated that the successful invocation of any defence based on this norm has to meet a two-tier test, so defined: “In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions — paragraphs (a) to (j) — listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX ...” (Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline* at p. 22).

Indonesia raised 37 exceptions to the 18 measures. (*Indonesia – Import Licences Regimes* at [7.507]). However, the panel dismissed 11, because they were invoked too late in the proceedings and did not give New Zealand the opportunity to respond to them. (*Indonesia – Import Licences Regimes* at [7.510]). Nonetheless and despite this dismissal, the panel admitted defences regarding each of the measures at issue in the dispute. (*Indonesia – Import Licences Regimes* at [7.519]). It rejected all.

For instance, Indonesia argued that the storage ownership requirement was justified under GATT Article XX(a), since the purpose of the measure was to ensure that Indonesian consumers had access to halal products, as mandated by Islamic law. (*Indonesia – Import Licences Regimes* at [7.637]). The panel responded that Indonesia had not provided evidence of the connection between the requirement and the protection of halal products. Nor had the regulation stated that the protection of halal products was one its objectives. (*Indonesia – Import Licences Regimes* at [7.655] – [7.657]). The panel, then, concluded that Indonesia had not demonstrated that there was a link between the measure and the protection of public morals as represented by halal products. (*Indonesia – Import Licences Regimes* at [7.660]).

Indonesia invoked Article XX(d) to justify the measures establishing limited application windows and fixed import terms for horticultural and animal products. The panel concluded that in its invocation of GATT Article XX(d), Indonesia had not met even the first tier of the test, since Indonesia had failed to identify the specific laws and regulations that the measures sought to ensure compliance with. Indonesia identified these regulations only in general terms, and the panel determined that this was not enough. (*Indonesia – Import Licences Regimes* at [7.581] – [7.585] & [7.594]).

Indonesia also invoked GATT Article XX(b) as justification for the storage ownership requirement, for it “is intended to ensure that fruits, vegetables and meat products for consumption are safe ...” (*Indonesia – Import Licences Regimes* at [7.662]). The panel noted that nowhere in the regulation was the protection of animal, health, and/or plant life stated as a policy objective and that Indonesia had not demonstrated the connection between the requirement and the protection of such values. (*Indonesia – Import Licences Regimes* at [7.678] & [7.682]).

Likewise, Article XX(b) was invoked by Indonesia to justify the reference prices for chillies and shallots. “For Indonesia, securing food supply presumes access to not only enough food to meet caloric intake, but also food that is safe for human consumption.” (*Indonesia – Import Licences Regimes* at [7.770]). The panel responded that Indonesia had not proven that its food security concern fell under Article XX(b) and that nothing in the implementing regulation contemplated food safety or food security as an objective. (*Indonesia – Import Licences Regimes* at [7.772] – [7.775]).

Article XX(b) was also raised as a defence that would justify the violation of Article XI.1 by the six-month harvest requirement. Given the evidence, the panel agreed with Indonesia that “consumers’ access to fresh horticultural products ... is associated with the storage of certain horticultural products

harvested more than six months before importation.” (*Indonesia – Import Licences Regimes* at [7.797]). However, to meet the first tier of the test under this provision, respondent members had to demonstrate that the requirement was *necessary* to protect human health. To do so, and according to well-established WTO case law, respondents must carry out a balancing test that involves several elements: the importance of the value pursued the contribution of the measure to the achievement of the goal, the trade-restrictiveness of the measure in question, and the existence of reasonably available less trade-restrictive alternatives. (*Indonesia – Import Licences Regimes* at [7.799]).

Regarding the contribution of the requirement to the achievement of human health, the panel stated that Indonesia had not addressed such contribution. On the contrary, there was evidence indicating that Indonesia allowed for the storage of horticultural products in its territory for more than six months. (*Indonesia – Import Licences Regimes* at [7.801]). The panel also found that there was a less trade-restrictive alternative that was reasonably available, identified by New Zealand: a certification requirement according to which all horticultural products must be inspected in the country of origin by virtue of existing Indonesian regulations. (*Indonesia – Import Licences Regimes* at [7.802]). The panel concluded that Indonesia had not proven that the requirement met the first tier of the test of Article XX(b).

However, the panel decided to proceed with the second tier of the test: an assessment of the measure in light of the introductory clause to Article XX. Following the Appellate Body, the panel stated that “for a measure to be applied in a manner which constitutes ‘arbitrary or unjustifiable discrimination between countries where the same conditions prevail’, three elements must exist: (i) the application of the measure must result in discrimination; (ii) the discrimination must be arbitrary or unjustifiable in character; and (iii) this discrimination must occur between countries where the same conditions prevail. As the Appellate Body indicated, “[t]he assessment of these factors ... was part of an analysis

that was directed at the cause, or the rationale, of the discrimination.” (*Indonesia – Import Licences Regimes* at [7.806]).

The panel found that only importers, not local distributors, had to comply with the six-month harvest requirement and that, therefore, there was discrimination between domestic and imported products. The panel concluded that the rationale for the discrimination had nothing to do with the objective of protecting human health and that the measure was not justified by Article XX(b). (*Indonesia – Import Licences Regimes* at [7.814], [7.823] & [7.827]).

### **Scope of Indonesia’s Appeal before the Appellate Body**

Unhappy with the result of the panel report, Indonesia appealed it before the Appellate Body. It challenged the panel’s findings and conclusions based on Article XI.1 regarding all of the 18 measures, the panel’s findings and conclusions regarding GATT Article XX, and the panel’s findings and conclusions regarding Article 4.2 of the Agreement on Agriculture. (*Notification of an Appeal by Indonesia under Article 16.4 and Article 17 of the Understanding on Rules and Procedures Governing the Settlement of Disputes* at [1] – [2]). Indonesia then accepted the panel’s conclusions regarding private actors’ actions and the dismissal of those GATT exceptions raised late during panel proceedings.

### **Comments on *Indonesia – Import Licences Regimes***

There are a few issues worth mentioning regarding this dispute. First of all, the panel report is a significant application of Article XI. States can always protect their industries but quantitative restrictions are an exceptional tool to achieve this goal. Second, the concepts of food security and sovereignty cannot be deemed as having been impaired conceptually as a result of the panel report. The adverse result is not due to the panel’s disregard for them, but to the legal strategy pursued by Indonesia in its defence of the measures. In any case, those concerned with food security may keep a

close eye on the Appellate Body report to see how it addresses this dimension of the Indonesian defences. The question is not whether or not food security can fall under Article XX(b), but whether Indonesia has *proven* that food security is an objective that falls under any of the GATT exceptions. The first is a legal question, while the second is a factual question. A negative answer to the second question does not prevent a positive answer to the first. In any case, a new negative answer by the Appellate Body may clarify under which conditions this proof takes place.

Third, Indonesia's defences seem at times not really strong in terms of facts and law, and such weakness is a bit difficult to explain. Indonesia is not new to the WTO dispute settlement system by any means. In fact, it prevailed not long ago against the United States in *United States – Measures Affecting the Production and Sale of Clove Cigarettes*. (WT/DS406/AB/R, 4 April 2012). There is no need to speculate much about the underlying reasons for this oddity. In any case, a full correction of course by Indonesia during the appeal proceedings is far from granted. Some deficiencies in terms of proofs will likely remain permanent.

Fourth, the fact that the United States is also a complainant is a point that could favour a settlement of the controversy in more beneficial terms for New Zealand in the event of a positive report by the Appellate Body. The measures are general regulations, which are not specifically targeting New Zealand products. Thus, how Indonesia complies with an adverse report in its dispute with the United States could in principle benefit New Zealand, absent any *de facto* discrimination. Worth mentioning is the fact that Indonesia has a certain latitude in determining how it complies with an adverse report or, in WTO parlance, in how it will bring its measures into conformity. A powerful WTO complainant will often have leverage to request a significant degree of conformity by the respondent Member.

Fifth, when could the New Zealand industries start getting the benefits of the legal victories? In the event of a favourable appeal, the WTO dispute settlement system has additional stages. The next is the calculation of the reasonable period of implementation, or in clear terms, how quickly Indonesia is going to comply. Usually, the maximum is 15 months after the adoption of the panel or Appellate Body report by the Dispute Settlement Body. (Article 21(3)(c) of the WTO Dispute Settlement Understanding (DSU)). The period of implementation is estimated on the basis of the type of action that is required to comply. Each case is different, but the late Christopher Beeby, a prominent New Zealand international law expert and former Appellate Body member, acting as arbitrator in *Indonesia – Certain Measures Affecting the Automobile Industry*, determined that the period of implementation in this case, involving administrative measures mainly, was 12 months. Beeby took into account that Indonesia was facing a major economic crisis at the time. (Award, Arbitration under Article 21.(3)(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes, *Indonesia – Certain Measures Affecting the Automobile Industry* at [24] – [25]). No similar situation is taking place today, so it is likely that a shorter period of time could be granted in the event of lack of agreement between the parties.

Thus, in the very best scenario, the NZ meat and horticultural industries could start experiencing the benefits of a favourable ruling by the end of 2018. Whether or not this will be the case depends also on the Indonesian industries' influence in attempting to preserve a certain degree of protection from their government when Indonesia adopts its measures to comply with the adopted reports, which could trigger additional WTO litigation—compliance proceedings under Article 21.5 of the DSU—and the ensuing delayed compliance.

Finally, the remedy of the dispute settlement system is exclusively for Indonesia to bring the measures into conformity with WTO law after the Appellate Body report is adopted by the WTO Dispute

Settlement Body (Article 19 DSU). Compensation to be paid to the exporters who have seen their exports to Indonesia reduced as a result of the measures is not contemplated.