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WTO Appellate Body Report: Colombia – Textiles

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Summary

Decision: The WTO Appellate Body has ruled that a Colombian law designed to combat money laundering violates Colombia's tariff obligations under Article II of the General Agreement on Tariffs and Trade (GATT) 1994.

Colombia argued that certain goods entering its territory at "artificially low prices" were being used to launder money, and therefore adopted a "compound tariff" to impose higher duties. In upholding the complaint by Panama, the Appellate Body rejected Colombia's argument that GATT Article II did not apply to illicit trade. It also rejected Colombia's arguments that its measure was "necessary to protect public morals" and "necessary to secure compliance" with Colombia's anti-money laundering laws.

Significance of decision

One noteworthy aspect of this decision is that it reinforces prior rulings on when WTO Members can adopt otherwise GATT-inconsistent laws on the grounds of "public morals".

GATT Article XX(a) provides that nothing in the GATT prevents the adoption or enforcement of measures "necessary to protect public morals". This language dates to the original GATT 1947, but was only invoked in three prior disputes until now. The fact that this defence has been raised in only a handful of cases in the history of the GATT/WTO may reflect the reluctance of many countries to override objective trade rules with something as subjective as "public morals".

The United States was the first country to invoke "public morals" in the 2004 case of *US – Gambling*, where it cited the parallel provision in the General Agreement on Trade in Services (GATS) to seek to uphold a prohibition on internet gambling. China followed suit in 2009 in *China – Publications and Audiovisual Products*, in which it argued that certain restrictions on the importation of publications and other products fell under the exception because "imported cultural goods... are vectors of different cultural values [and] may collide with standards of right and wrong conduct which are specific to China". The EU invoked public morals in

2014 in *EC – Seal Products*, seeking to uphold its ban on the importation of seal products on the grounds that "seal hunting is inherently inhumane and raises moral concerns". Colombia is the fourth country to argue that this exception should apply.

The pattern emerging from these cases is clear. WTO panels and the Appellate Body have been deferential to Members on what constitutes "public morals", but have held them to a strict standard in assessing whether such measures are nevertheless "necessary", and meet the requirements of the opening paragraph ("chapeau") of Article XX, which requires non-discriminatory application of the measure.

The cases have wisely declined to try to formulate a global or WTO standard of public morals. Instead, this will be defined by each country for itself. As noted by the Panel in *US – Gambling*, public morals can "vary in time and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values", and Members should be given "some scope to define and apply for themselves" such concepts "according to their own systems and scales of values".

But such measures will only be upheld if they are "necessary", and non-discriminatory. Indeed, the measures in *China – Publications and Audiovisual Products* were found not to be "necessary" and the measures in *US – Gambling* and *EC – Seal Products* both failed under the chapeau.

The Appellate Body ruling in *Colombia – Textiles* continues this pattern. It agreed that combating money laundering was "vital and important in the highest degree" but found that the Colombian measure was not "necessary", given the "lack of sufficient clarity regarding the degree of contribution of the measure at issue to the objective of combating money laundering and the degree of trade-restrictiveness of the measure".

The "public morals" defence thus remains a very narrow exception, and in the history of the WTO, no otherwise GATT-inconsistent measure has ultimately been upheld on this basis.

Report

Background: compound tariff to prevent money laundering

This dispute arose from a “compound tariff” imposed by Colombia on certain textiles, apparel and footwear. The measure consisted of a compound tariff (in the form of an *ad valorem* levy, expressed as a percentage of the customs value of the goods) and a specific levy. The Panel agreed with Panama that the compound tariff was a customs duty that exceeded the levels bound in Colombia’s tariff schedule, in violation of GATT Article II:1(a) and (b).

GATT Article II:1(a) requires each WTO Member to “accord to the commerce of the other contracting parties treatment no less favourable than that provided for” in its tariff schedule. Article II:1(b) adds that imported products shall be “exempt from ordinary customs duties in excess of those set forth” in the schedule.

Colombia argued that the thresholds incorporated in the compound tariff “reflected a distinction between licit imports, on the one hand, and imports that Colombia had determined were imported at artificially low prices to launder money, on the other hand”. Colombia also argued that “a measure designed to combat illegal trade operations that are not covered by Article II of the GATT 1994”.

GATT Article II: “illicit trade” not excluded

Colombia argued, among other things, that the Panel had failed to make an “objective assessment of the matter” within the meaning of Article 11 of the Dispute Settlement Understanding (DSU), because the Panel considered that it was “not necessary to issue a finding as to whether or not the obligations of Article II:1(a) and (b) of the GATT 1994 apply to what Colombia considers to be illicit trade”.

The Appellate Body agreed. It pointed to statements by the Panel that “the measure at issue applies, or could apply, to some transactions considered by Colombia to be illicit trade”, and so “the Panel was, in our view, required to address the interpretative issue before it...” The Appellate Body considered that “the Panel did not provide coherent reasoning, and that the basis upon which it refrained from interpreting Article II:1(a) and (b) of the GATT 1994 was flawed”, inconsistently with DSU Article 11 of the DSU.

The Appellate Body then considered Colombia’s request to “complete the legal analysis and find that Article II:1(a) and (b) does not apply to illicit trade and that, because imports priced at or below the thresholds are imported at

artificially low prices that do not reflect market conditions, the compound tariff does not violate Article II:1(a) and (b) of the GATT 1994”. The Appellate Body rejected this argument, reasoning that the text of Article II:1(a) and (b) did not exclude what Colombia classified as illicit trade. It affirmed that the compound tariff exceeded Colombia’s bound rate, in breach of GATT Articles II:1(a) and (b).

The Appellate Body stressed that:

[O]ur analysis set out above should not be understood to suggest that Members cannot adopt measures seeking to combat money laundering. This aim, however, cannot be achieved through interpreting Article II:1 of the GATT 1994 in a manner that excludes from the scope of that provision what a Member considers to be illicit trade. A Member’s right to adopt and pursue measures seeking to address concerns relating to money laundering can be appropriately preserved when justified, for example, in accordance with the general exceptions contained in Article XX of the GATT 1994.

The Appellate Body then turned to those Article XX defences.

Article XX(a): compound tariff not “necessary” to protect public morals

Colombia argued that the compound tariff could be justified as an exception under GATT Article XX(a) as a measure “necessary to protect public morals”.

The Appellate Body began by noting that “[i]n order to establish whether a measure is justified under Article XX(a), the analysis proceeds in two steps. First, the measure must be ‘designed’ to protect public morals. Second, the measure must be ‘necessary’ to protect such public morals”.

With respect to the “design” of the measure, the Appellate Body found that “the phrase ‘to protect public morals’ calls for an initial, threshold examination in order to determine whether there is a relationship between an otherwise GATT-inconsistent measure and the protection of public morals”. If the measure was “not incapable” of protecting public morals, then “further examination of whether the measure is ‘necessary’ is required under Article XX(a)”. The Appellate Body added that:

We do not see the examination of the ‘design’ of the measure as a particularly demanding step of the Article XX(a) analysis. By contrast, the assessment of the ‘necessity’ of a measure entails a more in-depth, holistic analysis of the relationship between the measure and the protection of public morals. The Appellate Body has

explained that a necessity analysis involves a process of 'weighing and balancing' a series of factors, including the importance of the societal interest or value at stake, the contribution of the measure to the objective it pursues, and the trade-restrictiveness of the measure. In most cases, a comparison between the challenged measure and possible alternatives should subsequently be undertaken.

Turning to the facts of the present case, the Appellate Body recalled that the Panel "recognized that at least some goods priced at or below the thresholds could be imported into Colombia at artificially low prices for money laundering purposes, and would thus be subject to the disincentive created by the higher specific duties that apply to these goods". This meant that "the Panel's analysis indicates that the compound tariff is not incapable of combating money laundering, such that there is a relationship between that measure and the protection of public morals". It was therefore "incumbent on the Panel to turn to the analysis of the 'necessity' of the measure to explore further the extent of that relationship in assessing the measure's contribution to the objective, and to evaluate any such contribution together with the other factors of the 'necessity' analysis".

The Appellate Body therefore reversed the Panel's findings that Colombia failed to demonstrate that the compound tariff is "designed" to combat money laundering and "protect public morals".

The Appellate Body then turned to examine whether the compound tariff was "necessary" to protect public morals. It began by agreeing with the Panel's unappealed finding that "the objective of combating money laundering reflects societal interests that can be described as vital and important in the highest degree".

It next analyzed "the contribution of the measure to combating money laundering". It noted that "while the Panel's findings indicated that there may be at least some contribution, they are also indeterminate as to the *degree* of such contribution" (original emphasis). For the Appellate Body, this indicated the Panel's view that "Colombia had not established with sufficient clarity the amount or proportion of import transactions involving the relevant products that are, in fact, undervalued for money laundering purposes". The Appellate Body concluded that:

[T]here was a lack of sufficient clarity regarding the degree of contribution of the measure at issue to the objective of combating money laundering and the

degree of trade-restrictiveness of the measure. Without sufficient clarity in respect of these factors, a proper weighing and balancing that could yield a conclusion that the measure is 'necessary' could not be conducted.

The Appellate Body therefore concluded that "Colombia has not demonstrated that the compound tariff is a measure 'necessary to protect public morals' within the meaning of Article XX(a) of the GATT 1994".

Article XX(d): compound tariff not "necessary" secure compliance with money laundering laws

GATT Article XX(d) provides the exception for WTO Members, in certain circumstances, to adopt measures "necessary to secure compliance" with GATT-consistent laws. Colombia argued that the compound tariff was necessary to secure compliance with a provision of the Colombian Criminal Code on money laundering.

The Appellate Body found that the Panel "erred in concluding that Colombia had failed to demonstrate that the measure is 'designed' to secure compliance with laws or regulations that are not GATT inconsistent given its recognition that the compound tariff is not incapable of securing compliance with... Colombia's Criminal Code..." The Appellate Body found that the Panel "prematurely ceased its analysis under this provision without proceeding to assess the degree of contribution of the measure to its objective, together with the other 'necessity' factors in a weighing and balancing exercise". It accordingly reversed the Panel's finding that Colombia failed to demonstrate that the compound tariff was "designed" to secure compliance with the money laundering provision of the Criminal Code.

The Appellate Body then assessed Colombia's request to "complete the legal analysis" and find that the compound tariff met the requirements of GATT Article XX(d).

The Appellate Body recalled the findings of the Panel that "at least some goods priced at or below the thresholds could be imported into Colombia at artificially low prices for money laundering purposes, and would thus be subject to the disincentive created by the higher specific duties that apply to these goods". In the view of the Appellate Body, "these findings establish the Panel's recognition that there may be at least some contribution by the measure to securing compliance with... Colombia's Criminal Code".

However, the Appellate Body added that “while the Panel’s findings that we have discussed indicate that there may be *at least some* contribution, they are also indeterminate as to the *degree* of such contribution”. The Appellate Body ruled that:

[O]ur assessment of the Panel’s findings reveals the Panel’s consideration that there was a lack of sufficient clarity with respect to several key aspects of the ‘necessity’ analysis concerning the defence that Colombia presented to the Panel under Article XX(d). In particular, there was a lack of sufficient clarity regarding the degree of contribution of the measure at issue to securing compliance with... Colombia’s Criminal Code, and the degree of trade restrictiveness of the measure. Without sufficient clarity in respect of these factors, a proper weighing and balancing that could yield a conclusion that the measure is ‘necessary’ could not be conducted. In the light of these considerations, the Panel’s findings support the conclusion that Colombia has not demonstrated that the conclusion resulting from a weighing and balancing exercise is that the measure at issue is ‘necessary’ to secure compliance with... Colombia’s Criminal Code.

The Appellate Body therefore ruled that “Colombia has not demonstrated that the compound tariff is a measure ‘necessary to secure compliance with laws or regulations which are not inconsistent’ with the GATT 1994, within the meaning of Article XX(d) of the GATT 1994”.

The Report of the WTO Appellate Body in *Colombia – Measures Relating to the Importation of Textiles, Apparel and Footwear* (DS461) was released on June 7, 2016.

Note from Brendan McGivern, head of the World Trade Organization (WTO) practice of the White & Case LLP and Executive Partner of the Firm’s Geneva office.

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