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Jeremmy Okonjo

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By
Jeremmy Okonjo *

ABSTRACT

The enactment of extraterritorial national legislation has traditionally elicited debate on its legitimacy, efficacy and enforceability. Since the 2007-2009 global financial crisis, some legislative jurisdictions, including the EU and the US, have increasingly enacted extraterritorial financial markets regulations to contain global systemic risk. More specifically, in response to the G20 Council of Ministers’ resolve to reform national and international over-the-counter (OTC) derivatives markets regulations, the EU has enacted the European Market Infrastructure Regulations (EMIR), which seeks to contain systemic risk, counterparty risk, and make the OTC derivatives markets more transparent. EMIR is extraterritorial to the extent that it imposes obligations on non-EU (third country) contract counterparties, central counterparties (CCPs), trade repositories, and OTC derivatives market regulators.

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The extraterritoriality of EMIR, alongside the US enactment of the US Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), has drawn contradictory commentaries. EU policy makers and legislators justify extraterritoriality on the basis of the need to protect EU derivatives markets from systemic risk and regulatory arbitrage. On the other hand, third country derivatives markets regulators, policy makers and market players, especially in emerging markets, argue that EMIR will have adverse effects on the stability and development of their derivatives markets.

This paper explores three closely-related research questions. First, what is the regulatory logic and methodology of EMIR’s extraterritorial provisions? Secondly, is the regulatory impact of these provisions proportionate as against third country emerging markets? Lastly, how can extraterritorial financial legislation by the EU be adapted to ensure both financial stability and the development of OTC derivatives markets in emerging economies? In exploring the above questions, this paper examines the extraterritorial provisions of EMIR from the perspective of the international law doctrine of proportionality.

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I. INTRODUCTION

The enactment of extraterritorial national legislation has traditionally elicited debate on its legitimacy, efficacy and enforceability.¹ Since the 2007-2009 global financial crisis, some legislative jurisdictions, including the EU and the US, have increasingly enacted extraterritorial financial markets regulations to contain global systemic risk.² More specifically, in response to the G20 Council of Ministers’ resolve to reform national and international over-the-counter (OTC) derivatives markets regulations, the EU has enacted the European Market Infrastructure Regulations (EMIR), which seeks to contain systemic risk, counterparty risk, and make the OTC derivatives markets more transparent.³ EMIR is extraterritorial to the extent that it imposes obligations on non-EU (third country) contract counter-parties, central counterparties (CCPs), trade repositories, and OTC derivatives market regulators.⁴

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Derivatives are financial instruments which derive their value from the price of an underlying asset or market variable. 10 They include forwards, futures, options swaps, and can take form as various asset classes, such as equity, interest rate, foreign exchange, credit, equity, and commodity derivatives. 11 These instruments are used by various transaction counterparties, including financial firms, investors,

7 This paper uses the terms “emerging markets”, “emerging economies” and “emerging market economies” interchangeably, for phonetic rather than conceptual reasons.
9 The paper relies on Vranes’ conception of the doctrine of proportionality, as outlined in Erich Vranes, Trade and the Environment (Oxford University Press 2009).
farmers and corporates, for hedging risks against, speculating on, and arbitraging in, changes in prices, rates, indices, or events such as credit defaults.

Derivatives also play an integral role in the wider global and national economies, including price discovery, risk pricing, and liquidity provision. Derivatives are of two types: exchange-traded derivatives, which are standardized contracts listed on securities exchanges and multilateral trading facilities (MTFs), and over-the-counter (OTC) derivatives, which are traded off-exchange. OTC derivatives carry the advantages of being flexible and tailor-made to the needs of contract counterparties.

After the 2008 global financial crisis, various industry, academic and high-level government inquiries, including the US Financial Crisis Inquiry Commission, and the EU De Larosière High Level Group, concluded that OTC derivatives markets significantly contributed to the financial meltdown. This was due to, at least, four fundamental characteristics of OTC derivatives contracts and their market structures. First, most derivatives contracts were traded bilaterally thereby making them opaque to unexposed third parties and potential liquidity providers who withheld credit support, exacerbating the credit crunch. Secondly, most

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12 Ibid; John J Stephens, Managing Currency Risk: Using Financial Derivatives (Wiley 2001); Kolb and Overdahl (n 10). However, users have developed creative use of derivatives to achieve other objectives, including circumventing financial regulations such as bank leverage limits, money laundering, and hiding of illicitly acquired wealth. See generally, Dominika Paula Ga³kiewicz, ‘Similarities and Differences between U.S. and German Regulation of the Use of Derivatives and Leverage by Mutual Funds’ 2 <http://edoc.hu-berlin.de/docviews/abstract.php?id=40940> accessed 18 June 2015.


14 Ibid.


counterparty exposures to OTC derivatives markets were non-collateralized, increasing counterparty risk.\(^{18}\) Thirdly, there was a high level of concentration, and therefore led to concentration of risk, in particular market segments.\(^{19}\) Lastly, the prices formed in derivatives markets determined the prices of other instruments,\(^{20}\) thereby increased the contagion risks between market segments.\(^{21}\)

The inquiries precipitated financial regulatory reforms at the international, regional and national levels.\(^{22}\) In November 2008, in response to this crisis, the G20 Council of Ministers resolved to reform the OTC derivatives markets regulations. They agreed that:

"All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."\(^{23}\)

In response to these G20 commitments, various countries, including the EU and the US, embarked on various OTC derivatives regulatory reforms. On August 16, 2012, the EU Parliament enacted EMIR, which seeks to contain systemic risk, counterparty risk, and make the OTC derivatives markets more transparent.\(^{24}\) EMIR imposes three main obligations on counterparties to derivatives contracts:

\(^{18}\) Jackson and Miller (n 12) 3; Mannmohan Singh, Collateral, Netting and Systemic Risk in the OTC Derivatives Market (International Monetary Fund 2010); Yuji Sakurai and Yoshihiko Uchida, ‘Rehypothecation Dilemma: Impact of Collateral Rehypothecation on Derivative Prices under Bilateral Counterparty Credit Risk’ (2014) 48 Journal of Banking & Finance 361.
\(^{19}\) Jackson and Miller (n 13); Adam Tickell, ‘Dangerous Derivatives: Controlling and Creating Risks in International Money’ (2000) 31 Geoforum 87.
\(^{20}\) Ibid.
\(^{24}\) EMIR (n 3).
a mandatory clearing obligation for specified OTC derivative contracts; risk
mitigation obligations in relation to uncleared OTC derivative contracts; and an
obligation to report all derivative contracts (both OTC and exchange-traded) to a
trade repository registered or recognised under EMIR.25

More significantly, while the obligations under EMIR apply primarily to EU entities, some of the core provisions will also apply to non-EU entities (third
countries) which deal with EU counterparties, or between two non-EU counterparties, where the transaction has a “direct, substantial and foreseeable
effect” within the EU, or “where necessary or appropriate to prevent the evasion
of EMIR”.26 This essentially brings all the non-EU OTC derivatives markets,
including developed and emerging markets, under EMIR’s jurisdiction.27

EMIR’s blanket extraterritoriality has raised concern regarding the negative impacts
that the regulation may have on emerging economies’ OTC derivatives market
growth and development.28 This is because of the unique market challenges faced
by these markets, such as poor market infrastructure, low liquidity, poor legal
and regulatory frameworks, and limited product diversity, which may not have
been taken into account by EMIR.29 This concern necessitates an analysis of EMIR,
for a justification of its extraterritoriality, its impact on emerging markets, and
how these impacts can be mitigated.30

25 Ibid.
26 Ibid; European Securities and Markets Authority, ‘Draft technical standards under EMIR on
contracts with a direct, substantial and foreseeable effect within the Union and non-evasion’
27 Ibid. The paper uses the term “emerging markets” and “emerging economies” interchangeably,
for phonetic rather than conceptual reasons.
28 Prasad (n 8); ‘Identifying the Effects of Regulatory Reforms on Emerging Market and
Developing Economies: A Review of Potential Unintended Consequences’ (n 22).
29 Financial Stability Board, The World Bank and International Monetary Fund, ‘Financial Stability
Issues in Emerging Market and Developing Economies’ (International Monetary Fund 2011)
np/g20/pdf/110211.pdf> accessed 8 July 2015.
30 Edward F Greene and Ilona Potiha, ‘Examining the Extraterritorial Reach of Dodd–Frank’s
Volcker Rule and Margin Rules for Uncleared Swaps—a Call for Regulatory Coordination and
Section 3 below lays down the theoretical and juridical framework for extraterritorial legislation in a globalized financial services sector, and then assesses the logic and methodology of EMIR’s extraterritoriality with respect to emerging markets.

III. THE EXTRATERRITORIALITY OF EMIR AND ITS APPLICATION TO OTC DERIVATIVES MARKETS IN EMERGING ECONOMIES

3.1. THEORETICAL AND JURIDICAL FOUNDATIONS OF EU’S EXTRATERRITORIAL LEGISLATION

The justification for extraterritorial OTC derivatives regulations, in regulatory theory, falls under at least two main (and related) theories of regulation: the “public goods” theory31 and the “tragedy of the commons” theory.32 The “public goods” theory posits that systemic risk is a “public goods” problem.33 Financial stability is a public good; it is non-excludable, and does not get exhausted or depleted by over-enjoyment.34 Therefore, most states will want to free-ride on the benefits of global financial stability, and leave a few states (argued by some as the EU and US taxpayers) to pick up the regulatory costs. Therefore, according to this view, the free-riders must be taxed by way of extraterritorial regulations.35 The “tragedy of the commons” problem is also seen in the context that the free-riding states fail to assume the costs that they impose on other states when they benefit from regulatory arbitrage, by creating regulatory safe havens.36

These two theories are mirrored by the concerns of EU and US regulators, regarding maintenance of systemically stable global financial markets, and the problem of alleged lack of initiative by other jurisdictions, especially non-EU emerging markets which were not as adversely affected (as the US and EU) by the

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34 Ibid.
35 Ibid.
36 Ibid; Hardin (n 32); Schwarcz (n 32).
2008 global financial crisis, in reforming their financial markets.\textsuperscript{37} EU and US regulators have therefore justified their use of extraterritorial OTC derivatives regulations to force regulatory reform on third countries. This is to ensure that EU and US taxpayers alone do not have to, once again, shoulder the burden of future bailouts.\textsuperscript{38}

The juridical difficulties of extraterritoriality are best understood against the backdrop of the international law concepts of sovereignty and non-interference.\textsuperscript{39} From a legislative perspective, the Treaty of Westphalia\textsuperscript{40} and Articles 2(1) and 78 of the UN Charter of the United Nations\textsuperscript{41} (hereinafter “UN Charter”) have entrenched sovereignty as a norm of international law, implying that a State has exclusive jurisdiction to exercise legislative authority and enforcement of laws within its territory.\textsuperscript{42} In addition, in the regulatory sphere, international comity requires national and international regulators to respect the jurisdiction of a country’s domestic regulators over its markets. While the State is subject to international law, it is not subject to the national law of another State.\textsuperscript{43}

\textsuperscript{37} Greene and Potiha (n 30) 272; Coffee (n 33).
\textsuperscript{40} Ronald Asch, The Thirty Years War: The Holy Roman Empire and Europe, 1618-48 (St Martin’s Press 1997).
However, a State’s sovereignty is not absolute. With the increase in immigration, transnational corporations, global cross-border trade, transnational crime, and borderless information technologies driven by globalization, international law has evolved certain exceptions whereby a State may enact a law and exercise legal jurisdiction over a person or activity outside of its territorial jurisdiction, or within the jurisdiction of another State. Such a law is extraterritorial.44

One such judicial exception was first pronounced in 1927 in the *Lotus case*45 by the Permanent Court of International Justice (PCIJ), which held that international law grants “a wide measure of discretion” to states, to apply national legislation to “persons, properties and acts outside their territory”.46 The Court added that the only limit to its discretion is that it should “not overstep the limits” placed by international law upon its exercise of extraterritorial jurisdiction.47 Since the PCIJ did not provide any delimiting guidelines on the exercise of the extraterritoriality discretion, its successor, the International Court of Justice, has in subsequent cases, clawed back the wide discretion.48

Since *Lotus*,49 international law has evolved certain principles to guide the exercise of extraterritorial jurisdiction.50 The most significant principle holds that there

45 The Case of the SS ’Lotus’ (France v Turkey) (1927) 1928 PCIJ Rep Ser No 10 18 (Permanent Court of International Justice).
46 Ibid.
49 The Lotus Case (n 45).
50 Ibid; Meessen (n 1); De Schutter (n 46).
must be a connection between the regulated entity and the state exercising extraterritorial jurisdiction (enacting State). This connection can be established on the basis of at least 6 principles: objective territoriality; the effects doctrine; the protective principle; nationality; passive nationality; and universal jurisdiction.

These principles are, arguably, increasingly taking the shape of customary international law. This is because they have been adopted by the highest courts in the two jurisdictions that have increasingly made use of extraterritorial legislation, especially in financial services regulation – the European Court of Justice (ECJ) and the US Supreme Court. In addition, third countries are increasingly complying especially with US extraterritorial legislation, with little resistance. In the case of Air transport Association of America and Others, the ECJ adopted the effects test to assert the legality of the extraterritorial application of the Emissions Trading Scheme (ETS) Directive to non-EU airlines. Similarly, the US Supreme Court, in NAB v Morrison, while rejecting the effects test, introduced the “transactional test” which reflected aspects of the effects doctrine, protective principle, and the concept of objective territoriality.

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51 ‘UN Doc A/61/10’ (n 44) 521.
52 Ibid; Koziel (n 47); De Schutter (n 46) 253. For an elaboration of these principles, see ‘UN Doc A/61/10’ (n 44); International Bar Association, Report of the Task Force on Extraterritorial Jurisdiction (International Bar Association 2008).
53 Report of the Task Force on Extraterritorial Jurisdiction (n 51) 17.
54 Ibid; Koziel (n 47) 2521; ‘UN Doc A/61/10’ (n 44) 521.
55 Case C.366/10, Air Transport Association of America and Others v Secretary of State for Energy and Climate Change (2011) 49 Common Mark Law Rev 2012 1113 (European Court of Justice).
The presence of extraterritorial jurisdiction, however, does not necessarily mean that an enacting State can legitimately and validly assert extraterritorial jurisdiction. Extraterritorial legitimacy and validity depends on how it measures up to various principles proposed by international, regional and national courts, international law jurists, and soft law. These include the closely-related principles of proportionality, reasonableness, balancing, *abus de droit*, international comity, and subsidiarity. Expectedly, there are varied formulations and expectations of these principles. However, the common thread that runs through them is that, since extraterritorial legislation such as EMIR distributes varying costs and benefits to the enacting State, and third countries, the enacting state has a duty to measure and balance its interests against third countries’ interests.

The above principles of legitimating extraterritoriality, it has been argued, are entrenched by various sources of international law. The doctrines of proportionality and balancing have been recognized in resolutions of the International Law Institute (ILI), general principles of national and international law, international customary law, international treaties and decisions of the ICJ. However, critics contend that it is not clear whether these doctrines are principles or rules of international law, and what the elements of the doctrines are.

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59 Report of the Task Force on Extraterritorial Jurisdiction (n 51) 50; ‘UN Doc A/61/10’ (n 44) 529.
60 Ibid; Vranes (n 9) 95.
62 Vranes (n 9) 95.
65 Ibid.
66 Ibid.
67 Vranes (n 9) 95.
are.\textsuperscript{68} They argue that this makes it difficult to justify these doctrines as international law.\textsuperscript{69} However, a review of the sources of these doctrines reveals an emerging pattern of understanding and assertion of the doctrines.

Vranes (2009) argues that the above doctrines can more or less fall under an umbrella doctrine of proportionality. He adapts the “three-tier test” emanating from legal theory, and EU and German judicial jurisprudence, comprising of the concepts of suitability, necessity and balancing, to constitute the umbrella doctrine of proportionality.\textsuperscript{70}

According to Vranes, extraterritorial legislation must, first, be \textit{suitable} to promote or achieve the regulatory goal. If the regulatory policy option is in fact unsuitable for achieving the desired goal, extraterritoriality cannot be justified.\textsuperscript{71} In addition, the extraterritorial regulatory measures must be \textit{necessary} to achieve the regulatory goal. Where a less arduous alternative regulatory policy can be adopted, the requirement of necessity is negated.\textsuperscript{72} Thirdly, the benefits of the extraterritoriality of the legislation to the third country must be fairly balanced against the cost of the extraterritoriality to the state whose jurisdiction is encroached. Where the costs exceed the benefits to the third country, extraterritoriality is illegitimated.\textsuperscript{73} The enacting state therefore has a duty to ensure that the extraterritorial legislation satisfies the three-tier proportionality doctrine.\textsuperscript{74}

Vranes’ doctrine of proportionality is susceptible to various criticisms, including that it is subjective, and difficult to measure, especially in relation to the interests of States.\textsuperscript{75} Nevertheless, it offers a neater legal theory from which related juridical

\textsuperscript{68} FA Mann, \textit{The Doctrine of International Jurisdiction Revisited after Twenty Years} (M Nijhoff 1985) 116. cited in Vranes (n 9) 95; Ryngaert (n 60); Karl M Meessen, ‘Antitrust Jurisdiction under Customary International Law’ (1984) 78 The American Journal of International Law 783.
\textsuperscript{69} Jacques HJ Bourgeois, ‘EEC Control over International Mergers’ (1990) 10 Yearbook of European Law 103, 127; Meessen (n 67).
\textsuperscript{70} Vranes (n 9) 95.
\textsuperscript{71} Ibid.
\textsuperscript{72} Ibid.
\textsuperscript{73} Ibid.
\textsuperscript{74} Ibid.
\textsuperscript{75} Ibid.
and theoretical pronouncements of valid assertion of extraterritorial legislation can begin to be packaged by international and national courts, policy makers, regulators and industry groups.

This paper adopts Vranes’ doctrine of proportionality as the conceptual framework for examining the extraterritorial provisions of EMIR, their impact on emerging economies’ OTC derivatives markets, and whether or not they impede the development of stable OTC derivatives markets. Section 3.2 below examines the effectiveness of EMIR in increasing transparency and ensuring financial stability in third country (emerging economies’) OTC derivatives markets.

3.2. Examining the Extent of Extraterritoriality of EMIR

EMIR imposes three main obligations on EU and non-EU counterparties to derivatives contracts: a mandatory CCP clearing obligation for specified OTC derivative contracts; risk mitigation obligations in relation to uncleared OTC derivative contracts; and an obligation to report all derivative contracts (both OTC and exchange-traded) to a trade repository registered or recognised under EMIR.76 It also imposes certain registration, compliance, and conduct of business obligations on non-EU CCPs and trade repositories that wish to provide clearing and reporting services, respectively, to EU entities, and third country branches of EU entities.77 EMIR also provides for certain equivalence provisions that third country regulators need to comply with, for the CCPs and trade repositories in their jurisdictions to be recognized under EMIR and be allowed to provide regulatory compliance services to counterparties under the regulation.78

The extent of EMIR’s application to counterparties is determined by whether a counterparty is established in the EU, whether it is a Financial Counterparty (FC), or a Non-financial Counterparty (NFC), and, if it is an NFC, whether the amount of its derivative trade exceed a designated financial threshold.79 NFCs with trading volume of over £1 billion in gross notional value for OTC equity

76 Articles 4(1), 9, and 11 of EMIR (n 3).
77 Articles 25 and 77 of EMIR (n 3).
78 Article 13(2) of EMIR (n 3).
79 Article 2 of EMIR (n 3).
and credit derivatives, or £3 billion in gross notional value for foreign exchange, interest rate and commodities derivatives are classified as “NFC+ Counterparties.”

This section examines the logic and methodology of EMIR’s extraterritorial obligations. This includes: reporting, clearing and risk mitigation obligations vested on third country counterparties, registration and compliance obligations of third country CCPs and trade repositories, and equivalence provisions for third country regulators.

### 3.2.1. Application of EMIR Reporting Obligations to Third Country Emerging Market Counterparties

In financial regulation, the Efficient Capital Markets Hypothesis (ECMH) holds that financial markets are information-efficient. This means that the capital markets are extremely efficient in reflecting incorporating and reflecting new information about securities and markets, in their respective prices.\(^81\) Hence, markets with information asymmetry are considered to be un-optimally priced.\(^82\) Consequently, the ECMH has provided the strongest regulatory rationale for not only market-based economic models, but also information disclosure regulations for augmenting market efficiency.\(^83\)

However, since originally posited by Eugene Fama in 1970, the ECMH has faced a lot of critique: behavioural economists describe markets as irrational, and driven by fear and greed;\(^84\) others blame the ECMH for the formation of the real estate bubble.\(^85\)

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\(^{80}\) Ibid.


\(^{82}\) Ibid.


and stock market bubbles85; yet others argue that the increasingly automated markets such as algorithmic-driven, high-frequency trading, do not operate on information disclosure.86 Most especially, the failure of the sub-prime mortgage markets to detect the inherent systemic risks prior to the global financial crisis, despite the litany of US, EU and other jurisdictions’ disclosure regulations, pointed to the weaknesses of the ECMH.87 Nonetheless, despite these criticisms, the ECMH has continued to provide the regulatory rationale for market-based economic models, and also information disclosure regulations for augmenting market efficiency.88 Corporate and securities disclosure regulations have therefore been considered by regulators as a critical element for efficient capital markets, and consequently, critical to the OTC derivatives markets.89

The global OTC derivatives markets are largely opaque, exacerbating counterparty risk.90 Since OTC derivatives contracts are privately negotiated, information on the terms of the contract, and the extent of exposure of the counterparties, is available only to the counterparties.91 This has certain negative implications on risk management.

First, regulators are unable to assess risk profiles of market segments, regulated firms, and counterparties, impairing their ability to detect systemic risk issues

87 Tanega (n 84).
88 Gilson and Kraakman, ‘Market Efficiency after the Financial Crisis’ (n 82); Ball (n 84); Lo (n 83).
90 Jackson and Miller (n 13) 12; Koeppl, C.D. Howe Institute (n 16); Bartlett (n 17).
91 Ibid; ‘COM (2009) 332 Final’ (n 6) 15.
and apply regulatory responses. The failure of Lehman Brothers is a classic case. 

Secondly, counterparties are unable to assess the accurate exposure of their counterparties, and therefore do not contract based on true credit worthiness or risk exposure. This results in less collateral being set aside to secure exposure. In addition, in distressed markets, liquidity providers are reluctant to provide credit to counterparties whose credit exposure is unknown. It is this scenario that unfolded in the case of American International Group (AIG), the seller of Credit Default Swaps (CDSs), which, unknown to the market, was over-exposed to the US sub-prime mortgage market.

After the 2007 global financial crisis, mandatory reporting obligations emerged as a significant pillar of the efforts to increase the transparency of the OTC derivatives market. Article 9 of EMIR requires EU Counterparties transacting with either EU or non-EU Counterparties to report details of any derivatives contracts “concluded, modified or terminated”, to a trade repository registered or recognized under EMIR. The details include the parties to, and the main characteristics of, the derivatives contracts.

Whereas the reporting obligations do not apply to non-EU Counterparties, they are indirectly bound by the obligations when they transact with EU Counterparties. This is because the EU Counterparties request for the outlined information, in order to comply with their reporting obligations. Non-EU entities will have to comply with the reporting obligations if they are to continue transacting with EU Counterparties, regardless of the illegality of the reporting exercise under the respective third country’s data protection and confidentiality laws.

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93 Ibid.
94 Ibid.
95 Jackson and Miller (n 13) 3.
97 Coffee (n 33) 6, 7.
99 Article 9 of EMIR (n 3).
100 Ibid.
101 Ibid.
Most emerging market regulators agree that trade reporting will increase market transparency, but caution that trade repositories and related infrastructure should only be mandated if “economically affordable and functionally useful”. Based on emerging markets’ limited involvement in the global, US and EU Credit Default Swaps (CDS) OTC derivatives markets, which fuelled the crisis, and poor infrastructure and liquidity problems, implementation of reporting obligations in their markets may not have any immediate benefits for the stability of EU markets. However, it will certainly constrain emerging markets, as discussed in section 4 below.

3.2.2. Application of EMIR CCP Clearing Obligations to Third Country Counterparties from Emerging Market

In OTC markets, counterparty risk is mitigated through, among other mechanisms, bilateral clearing or CCP clearing. According to the International Swaps and Derivatives Association (ISDA) 2010 Margin Survey, about 70% of OTC derivatives transactions were cleared bilaterally. This entails the counterparties entering a Master Confirmation Agreement which provides for how the counterparties manage their respective credit exposures, including through exchange of collateral, which varies based on varying credit exposures.

However, bilateral clearing is costly and time-consuming to small dealers, due to daily valuation and re-collateralization requirements. It is also fraught with valuation methodology disputes that delay collateralization. In addition, on average, collateral covers only about 66% of credit exposure. Lastly, it is costly and

103 Ibid; ‘The de Larosière Report’ (n 16) 7.
104 See section 4 below.
107 See generally, Paul Harding, Mastering the ISDA Master Agreements: A Practical Guide for Negotiation (3 edition, Financial Times/ Prentice Hall 2010); Gregory (n 104).
inefficient to assess credit exposures in a complex web of bilateral counterparty credit exposures. The implication of all these shortcomings is that in distressed markets, when a counterparty receives a margin call, it may not have sufficient liquidity to meet the call, or even borrow, and will therefore default, as was the case with AIG.109

The weaknesses of bilateral clearing were exposed in the credit crisis, precipitating calls by national, regional and international regulators for mandatory CCP clearing of OTC derivatives trades.110 A CCP mitigates the shortcomings of bilateral clearing by netting counterparty exposures multilaterally, and guaranteeing that a counterparty will not default on its contractual obligations.111 In addition, it provides a framework for mark-to-market valuation, collateralization, daily monitoring of positions, mutualisation of risk, and a default fund.112 The CCP achieves this function by the legal mechanism of novation, whereby it interposes itself between counterparties to a derivatives contract, thereby becoming the counterparty to both the buyer and seller, separately.113 In this way, all clearing counterparties have rights and obligations against the CCP, which is then in a position to efficiently value each contract and exposure on a daily basis, and extract additional collateral from the counterparties.114

However, the logic and effectiveness of CCP clearing as a solution to counterparty risk has also been questioned. It has been argued that CCPs do not extinguish credit risk; they only reallocate it.115 In addition, CCPs introduce other risks by


110 The Future Regulation of Derivatives Market (n 107) 82.


112 Ibid.


114 See generally, Craig Pirrong, The Economics of Central Clearing: Theory and Practice (International Swaps and Derivatives Association 2011); Gregory (n 104) 97.

115 Gregory (n 104) 118.
stripping the counterparties of the bilateral incentive to properly price and manage counterparty risk. The regulation of CCPs may create other risks, including a regulatory risk whereby one or a few CCPs are unduly favoured, resulting in sub-optimal outcomes and market instability, and operational risks occasioned by interoperability requirements (discussed further below). Indeed, there are concerns that the concentration of risks in the CCPs, and the increasing trend of CCP mergers across Europe and the US, will recreate “too-big-to-fail” financial institutions, thereby exacerbating systemic risk in the OTC derivatives markets.

Nevertheless, for the functionalities outlined earlier above, EMIR extends CCP requirements to third countries, including emerging markets. Article 4(1) of EMIR requires the clearing of all standardized OTC derivatives contracts between:

(i) EU Financial Counterparties and/or NFC+ Counterparties;

(ii) Either an EU financial counterparty or an NFC+ Counterparty and a non-EU Counterparty that would be deemed a Financial Counterparty or an NFC+ if it were established in the EU; and

(iii) Two non-EU Counterparties that would each be either a Financial Counterparty or an NFC+ Counterparty if they were established in the EU, provided the contract has a “direct, substantial and foreseeable effect” within the EU or if it is necessary or appropriate to prevent the evasion of EMIR.

The Regulatory Technical Standards (RTS) published by ESMA in November 18, 2013, clarifies that a contract has “direct, substantial and foreseeable effect”

117 David Murphy, *OTC Derivatives: Bilateral Trading and Central Clearing: An Introduction to Regulatory Policy, Market Impact and Systemic Risk* (Palgrave Macmillan 2015) 262. This is significant, since CCPS concentrate counterparty and operational risk, thereby magnifying systemic risk associated with their failure.
119 EMIR (n 3).
121 ESMA (n 25). The use of the terms “direct, substantial and foreseeable effect” could be deemed as a legislative attempt at ensuring that the extraterritoriality of the provision falls within the effects test discussed in section 3.1 above.
where either of the two conditions are satisfied: either, the contract is guaranteed by an EU Financial Counterparty; or both counterparties are EU branches of respective non-EU entities.\footnote{121}

Emerging markets regulators acknowledge the utility of CCP clearing in reducing counterparty credit risk. However, they are concerned that establishing CCPs in small OTC markets will be too costly, and should only be mandated where the benefits exceed the costs.\footnote{122} In addition, they warn that it will lead to risk concentration in the CCPs.\footnote{123} Another concern is that CCPs are essentially a private law contracting device, and mandating it in legislation will create implementation problems, since the law will have to import the entire corpus of private law of CCP transacting, requiring very detailed and technical regulations.\footnote{124} Section 4 below discusses these implications in further detail.

### 3.2.3. Application of EMIR Risk Mitigation Requirements to Third Country Emerging Market Counterparties

The earlier discussion above has highlighted the inefficiencies of bilateral clearing and how CCP clearing can mitigate counterparty credit risk that stems from these inefficiencies.\footnote{125} By providing for clearing thresholds, EMIR acknowledges that not all OTC derivatives trades can be centrally cleared, and will therefore be vulnerable to counterparty credit risk and operational risk.\footnote{126} To mitigate counterparty credit risk in bilaterally cleared contracts, there is need for mandated risk-mitigation measures such as exchange of collateral, since in unregulated trades, the Counterparties sometimes waive the exchange of collateral if the other Counterparty has good credit rating.\footnote{127}

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\footnote{122} ‘IOSCO Emerging Markets Committee Report FR07/10’ (n 101) 33. \textit{See also}, Alexander and Dhumale (n 110) 252.  
\footnote{123} \textit{Ibid}.  
\footnote{125} See section 3.2.2 above. \textit{See also}, ‘COM (2009) 332 Final’ (n 6).  
\footnote{126} Recital 24 of EMIR (n 3). \textit{See generally}, Che Sidanius and Anne Wetheril, ‘Thoughts on Determining Central Clearing Eligibility of OTC Derivatives’. The authors argue that derivatives contracts should only be eligible for CCP clearing where the contracts are standardized and liquid, and also where the operational aspects of clearing the specific contracts are automated.  
\footnote{127} \textit{Ibid}; Jackson and Miller (n 13) 3.
Another typology of risks - operational risk - in OTC derivatives trades, arises from, among other reasons, inefficient and low levels of standardization in contract specifications and transaction processes. Operational failures limit transparency, and give way to legal risks, credit risks, and other risks. An example is where non-confirmation of trades results in unenforceable contracts, and therefore, Counterparty credit risk. These operational risks can be mitigated by the automation of trade processes, and the standardization of contracts and contract processes and infrastructure. These processes include contract confirmation, valuation, dispute resolution, portfolio reconciliation and portfolio compression.

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128 See Gregory (n 104). The author lists operational risk as “human error (such as trade entry mistakes), failed processes (such as settlement of trades or posting collateral), model risk (inaccurate or badly calibrated models), fraud (such as rogue traders) and legal risk (such as the inability to enforce legal agreements such as those covering netting or collateral terms)”. See also, ‘COM (2010) 484’ (n 6) 484.

129 Ibid; Ghouri (n 10).


131 Contract confirmations refers to both the documentation, and the process of reducing into writing, the economic terms of a particular trade agreed orally by dealers over the telephone. Confirmations are concluded within a previously agreed framework of a Master Agreement. See Philip R Wood, Set-off and Netting, Derivatives, Clearing Systems: V. 4 (2nd Revised edition edition, Sweet & Maxwell 2007) 252.

132 Valuation refers to the process of determining a contract’s current market value, by averaging the value of similar contracts from various trading venues such as exchanges and trading platforms. This value determines the counterparties’ further trading decisions. Aside from the contracts, the collateral posted by the Counterparties are also valued periodically to determine whether their market value sufficiently covers a party’s credit risk at a particular time. See Khader Shaik, Managing Derivatives Contracts: A Guide to Derivatives Market Structure, Contract Life Cycle, Operations, and Systems (Apress 2014) 237.

133 Trade counterparties may dispute contract and collateral valuations, including trade population, trade valuation methodology, and the application of netting rules by either counterparties or valuation agents. The contracts usually make provision for dispute resolution mechanisms in the event of such disputes. See Gregory (n 104).

134 Portfolio reconciliation refers to the process of reconciling the positions between organizations in order to minimize operation risk created by discrepancies between counterparties and other sources. Reconciliation service providers operate platforms on which participants load contracts. The service providers reconcile the positions, and sends the results to participants for confirmation. This process helps reduce collateral mismatches. See Shaik (n 131) 139.

135 Trade compression refers to the process of multilateral netting of various bilateral contracts, without a CCP, and without changing the risk profile, due to redundancies created by certain trades such as unwinds. Dealers with substantial opposite positions terminate off-setting contracts before they expire. In this process, various contract counterparties submit their relevant trades for compression, which are matched according to the counterparty to the trade, and cross-referenced against a trade-reporting warehouse. Some trades are terminated and replaced, and these changes become legally binding. See ibid; Gregory (n 104) 55.
Article 11 of EMIR requires uncleared OTC derivatives contracts concluded between the following parties, to be subject to risk mitigation techniques:

(i) EU Financial Counterparties and/or Non-financial Counterparties; or

(ii) A non-EU Counterparty and either an EU Financial Counterparty or EU Non-financial Counterparty, where the EU Counterparty is subject to the EMIR risk mitigation techniques obligations; or

(iii) Two non-EU Counterparties that would each be either a Financial Counterparty or a Non-financial Counterparty if they were established in the EU, provided the contract has a “direct, substantial and foreseeable effect within the EU or otherwise “where necessary or appropriate to prevent the evasion of EMIR”. 136

The risk mitigation techniques include timely confirmations, portfolio reconciliation and compression, dispute resolution, marking-to-market and marking-to-model,137 collateralization, increased capital requirements, and reporting of unconfirmed trades.138 Notably, there has been debate regarding the use of marking-to-market accounting/valuation (or fair value accounting), and how this technique can spread financial crisis, considering its role in the reduction to junk status of financial instruments of many US financial institutions, in the run-up to the 2008 global financial crisis.140 Since the debate is not settled, it is

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136 Article 11 of EMIR (n 9); ESMA (n 25).
137 Marking-to-market (MtM) refers to the process of calculating or valuing what could be lost in a trade on a particular date, by reference to market movements and funding liquidity, so as to determine the margin call (cash or collateral) required to be made by a counterparty. It is also known as fair value accounting. See Thomas S Coleman, Quantitative Risk Management: A Practical Guide to Financial Risk (Wiley 2012) 509; Gregory (n 104) 33.
138 Marking-to-Model refers to the process of pricing trade positions, similarly to Marking-to-Market, but based on internal assumptions or financial models, such as analytically derived expectations of future cash flows, rather than market prices for identical trades/assets. This approach is used for illiquid contracts, or in conditions where markets are illiquid. See generally, Anthony Meder and others, ‘Structured Finance and Mark-to-Model Accounting: A Few Simple Illustrations’ (2011) 25 Accounting Horizons 559, 559.
139 Article 11 of EMIR (n 9); ESMA (n 103).
therefore necessary to examine further the utility of this technique in making OTC derivatives markets safer.

Nevertheless, there seems to be consensus that these standardization and risk mitigation measures would make OTC derivatives markets, including emerging markets, safer. However, the effectiveness of these measures in emerging markets would have to be assessed in context of their level of development.\footnote{Prasad (n 8); Ghouri (n 10) 11; ‘Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences’ (n 22).} The impact of the risk mitigation obligations on third country emerging economies’ derivatives markets has been discussed in detail in Section 4.

3.2.4. Application of EMIR Organizational, Conduct of Business and Prudential Regulations on Third Country Emerging Market CCPs

The discussion in section 3.2.2 above has shown how, by virtue of their clearing role, CCPs attain a significant systemic role in the financial sector.\footnote{Murphy (n 116); ‘COM (2010) 484’ (n 6).} In addition, since they attain regulatory status from the legislative requirement for CCP clearing, CCPs also attain a regulatory agency role in the containing of systemic risk in the OTC derivatives sector.\footnote{This regulatory agency role emerged by virtue of the introduction of regulation mandating CCP clearing. Before EMIR, CCPs were a private market innovation for regulating systemic risk. See generally, Randall S Kroszner, ‘Role of Private Regulation in Maintaining Global Financial Stability, The’ (1998) 18 Cato J. 355; Randall S Kroszner, ‘Central Counterparty Clearing: History, Innovation, and Regulation’ (Social Science Research Network 2006) SSRN Scholarly Paper ID 948773.} This new status magnifies certain regulatory concerns related to CCPs.

First, before EMIR, there was no passporting regime, hence the need for multiple regulatory compliance for cross-border clearing.\footnote{The clearing and settlement costs of cross-border transactions across the EU were estimated at between 10-12 times that of domestic transitions. See Huang (n 112) 193. See also, Cynthia Hirata de Carvalho, ‘Cross-Border Securities Clearing and Settlement Infrastructure in the European Union as a Prerequisite to Financial Markets Integration/ : Challenges and Perspectives’ (Hamburg Institute of International Economics (HWWA) 2004) HWWA Discussion Paper 287; Torsten Schaper, ‘Trends in European Clearing and Settlement Industry - The European Code of Conduct and Target2-Securities’ (Social Science Research Network 2007) SSRN Scholarly Paper ID 965407.} Secondly, there was no EU-wide competition regulatory framework, undermining efforts at realizing
interconnection and interoperability among CCPs in different EU states.\(^{145}\) These two factors undermined provision of cross-border clearing services.\(^{146}\) Thirdly, increased competition in the CCP sector, occasioned by MiFID’s promotion of multi-lateral trading facilities (MTFs) has also resulted in a risk-management “race to the bottom”, where CCPs have had to compromise high risk management standards in a bid to reduce clearing fees and remain competitive.\(^{147}\) This exacerbated systemic risk concerns in the OTC derivatives sector. Lastly, the legal and operational framework for CCPs did not provide for the transfer or portability of positions and collateral from a defaulting clearing member to another clearing member.\(^{148}\) The consequences were that in the event of default by a clearing member, market participants would have to close their positions, and then replace the contract.\(^{149}\) This process left a counterparty vulnerable to market risk.\(^{150}\)

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\(^{146}\) Interoperability refers to standard unilateral access between CCPs, which promotes freedom of choice among contract counterparties, and competition between CCPs. This can have the effect of reducing the cost of cross-border clearing services. See generally, Xiaobing Feng and Matthew Pritsker, ‘The Structural Comparison of Central Counterparty Interoperability’ (2014) 25 International Journal of Modern Physics C 1450049.

\(^{147}\) The Market in Financial Instruments Directive (MiFID) was enacted by the EU Parliament in 2004, with the aim of abolishing concentration rules, and increasing competition and consumer protection in investment services. The effect was the promotion of new alternative trading platforms, which rivalled established exchanges and clearing and settlement industry. See Schaper and Chlistalla (n 144) 51; Nadia Linciano, Giovanni Siciliano and Gianfranco Trovatore, ‘The Clearing and Settlement Industry: Structure, Competition and Regulatory Issues’ [2005] Competition and Regulatory Issues (May 2005).

\(^{148}\) Gregory (n 115) 213. The main legal and operational frameworks that ensure efficient porting following a clearing member’s default are: identification of positions and margins, transferability of unencumbered margin and positions, and legal segregation of client margin from clearing member’s margin.

\(^{149}\) ‘COM (2010) 484’ (n 6). Since then, the Bank for International Settlements and IOSCO have issued regulatory standards known as Principles for Financial Market Infrastructures, outlining necessary legal frameworks for portability. Principle 14 on segregation and portability provides that CCPs should have rules and procedures that effectively protect participants’ customers’ positions and collateral from the default or insolvency of that participant, ensure establishment of client trust accounts by clearing members, and ensure the portability of positions and collateral of defaulting participants’ customers to other clearing members. See Group of Ten and others, Principles for Financial Market Infrastructures (Bank for International Settlements 2012) 82.

\(^{150}\) Gregory (n 115).
These regulatory concerns called for regulation of CCPs not only by the EU but also by third country CCPs, so as to ensure a systemically sound CCP clearing framework, and to promote cross-border provision of clearing and other financial services.\textsuperscript{151} Article 25 of EMIR prohibits third country CCPs from providing clearing services to clearing members or trading venues established in the EU unless the CCP is recognized by ESMA.\textsuperscript{152} Remarkably, this restriction is not limited to OTC derivatives clearing, and in fact covers all clearing services in relation to all financial instruments.\textsuperscript{153} In addition, the restriction covers provision of clearing services to non-EU branches of EU entities.\textsuperscript{154}

Third country CCPs have to comply with four conditions to be recognized by ESMA.\textsuperscript{155} First, the CCP must be authorized in the third country, and subject to effective supervision and enforcement.\textsuperscript{156} Secondly, ESMA must have established cooperation arrangements with the respective third country regulator.\textsuperscript{157} Thirdly, the CCP must be established or authorized in a third country with equivalent “anti-money laundering and financing of terrorism” laws.\textsuperscript{158} Lastly, the EU

\begin{itemize}
\item \textsuperscript{151} de Carvalho (n 143); Linciano, Siciliano and Trovatore (n 146); Schaper (n 143).
\item \textsuperscript{152} Article 25 of EMIR (n 3).
\item \textsuperscript{153} Ibid.
\item \textsuperscript{154} Ibid.
\item \textsuperscript{155} By September 15, 2013, up to 30 third country CCPs had applied for recognition under Article 25 of EMIR. By April 2015, ESMA had recognized only ten third country CCPs established in Australia, Hong Kong, Japan, and Singapore.
\item \textsuperscript{156} This requirement is satisfied by the making of an equivalence decision by the European Commission regarding a third country’s regulatory regime.
\item \textsuperscript{157} By April 2015, ESMA had entered cooperation arrangements with regulators in 4 countries: Australia, Hong Kong, Japan, and Singapore.
\item \textsuperscript{158} The inclusion of anti-money laundering and financing of terrorism (AML-FT) laws as part of the recognition criteria begs the question what this has to do with systemic risk in OTC derivatives. This could point back to the critique of international AML-FT standards as attempts by major international financial centres e.g. in the EU, to ease offshore competitive pressures. See Eleni Tsingou, ‘Global Financial Governance and the Developing Anti-Money Laundering Regime: What Lessons for International Political Economy&quest’ (2010) 47 International Politics 617. Some authors have tried to tie AML-FT agenda to systemic risk, by arguing that financial instability presents opportunities for money laundering. See Navin Beekarry, ‘International Anti-Money Laundering and Combating the Financing of Terrorism Regulatory Strategy: A Critical Analysis of Compliance Determinants in International Law’ (2011) 31 Northwestern Journal of International Law & Business 137, 137. However, this still doesn’t make sense in the context of using extraterritorial legislation to make OTC derivatives markets safer, especially considering the Western-oriented discourse on AML-FT that discredits any non-Western banking system e.g. the Hawalla network, as “underground banking”. See Marieke de Goede, ‘Hawala Discourses and the War on Terrorist Finance’ (2003) 21 Environment and Planning D: Society and Space 513.
\end{itemize}
Commission must have made an equivalence decision under article 25(6) declaring that the third country regulatory framework for the CCPs is equivalent to EMIR, the regulatory frameworks for supervision of the CCPs and enforcement are effective, and the third country regulatory framework provides for an effective equivalent system for the recognition of CCPs in third countries.¹⁵⁹

These conditions are beyond the control of emerging market CCPs (especially in third countries that are not members of the G20), which are, therefore, likely to not fulfil the conditions. This is because the fulfillment of the conditions lies in the hands of the third country legislators, policy makers and regulators, and EC and ESMA.¹⁶⁰ In addition, the equivalence provisions, discussed below, are difficult for third country emerging market regulators to comply with.¹⁶¹ This means that EU entities may withdraw from third country emerging markets, since they cannot find compliant CCPs to transact with. These consequences have been discussed in further detail in Section 4.

### 3.2.5. Application of EMIR Data Provision Requirements on Third Country Emerging Market Trade Repositories

Section 3.2.1 above discussed the problem of transparency in erstwhile opaque OTC derivatives markets, and how mandatory reporting mitigates systemic risk.¹⁶²

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¹⁵⁹ The increasing use of “equivalence” provisions by the EU has been labelled regulatory imperialism, especially considering the increased regulatory capacity of the EU. See Kristina St Charles, ‘Regulatory Imperialism: The Worldwide Export of European Regulatory Principles on Credit Rating Agencies’ (2010) 19 Minn. J. Int'l L. 399; Niamh Moloney, ‘The Legacy Effects of the Financial Crisis on Regulatory Design in the EU’ in Eilís Ferran and others (eds), _The Regulatory Aftermath of the Global Financial Crisis_ (Cambridge University Press 2012). In addition, it is also seen as the EU’s effort to maintain international competitiveness against “offshore” financial centres taking advantage of regulatory arbitrage. See Lucia Quaglia, ‘The Politics of “Third Country Equivalence” in Post-Crisis Financial Services Regulation in the European Union’ (2015) 38 West European Politics 167, 168.

¹⁶⁰ For example, the disagreements between the EU and US regulators regarding the differences between EMIR and Dodd-Frank extraterritorial provisions led to the delay in making of equivalence decisions by ESMA and the EC, leaving CCPs in more than 30 countries in limbo as they awaited resolution of the issues. See generally, Lüttringhaus (n 2).

¹⁶¹ Alexander and Dhumale (n 110) 252.

In addition to the reporting requirement that applies to Counterparties, EMIR also applies certain regulatory compliance obligations to trade repositories.\textsuperscript{163}

Before the enactment of EMIR, there were few unregulated trade repositories, including TriOptima and the Warehouse Trust.\textsuperscript{164} The problems with the unregulated nature of trade repositories were at least threefold. First, since the trade repositories were under no legal obligation to provide data requested by regulators, they would only furnish information for regulatory purposes upon compulsion by a court order.\textsuperscript{165} This took time and was inefficient in instances where regulators were required to take quick action during a financial crisis.\textsuperscript{166}

Secondly, the unregulated warehouses were under no obligation to operate in the best interests of the various parties in the OTC derivatives market such as regulators and market participants, on issues such as data confidentiality, quality and accuracy, reliability, and the bundling of services.\textsuperscript{167} Thirdly, since, with the anticipated requirement for trade reporting, the trade repositories would acquire a

\textsuperscript{163} Article 77 of EMIR (n 3).

\textsuperscript{164} Trade repositories, as unregulated market innovations, served the function of receiving and maintaining data on credit derivatives, for purposes of other post-trade processes, including electronic confirmation, portfolio reconciliation, trade compression and multilateral netting. See Gregory (n 104) 56. For example, from 2006, all major dealers voluntarily submitted data on credit derivatives to the Warehouse Trust via an electronic matching and confirmation platform – Deriv/SERV. See Bank for International Settlements and International Organization of Securities Commissions (n 161) 44.

\textsuperscript{165} COM (2010) 484 (n 6) 15. Article 63 of EMIR now gives ESMA, with the cooperation of a national competent authority, the power to carry out on-site inspections at any business premises or land of a trade repository, except over information or documents subject to legal privilege. For a judicial opinion on the exercise of these powers in the UK, see the UK High Court’s judgment in European Securities and Markets Authority v DTCC Derivatives Repository Limited [2015] EWHC 1285 (Ch), in which the High Court clarified the process that the European Securities and Markets Authority (ESMA) will need to follow in order to obtain authorisation to carry out an inspection of a trade repository in England.

\textsuperscript{166} COM (2010) 484 (n 6) 15. For the policy justification for regulator access, see Group of Twenty and others, Authorities’ Access to Trade Repository Data (Bank For International Settlements/ ; IOSCO 2013).

\textsuperscript{167} COM (2010) 484 (n 6) 15.
regulatory agency role, there was a need to ensure that their infrastructure embodied safety and integrity.\textsuperscript{168}

EMIR therefore seeks to regulate trade repositories to which OTC derivatives trade counterparties report their contracts. Article 77 of EMIR requires that third country trade repositories providing regulatory reporting services to EU entities under Article 9 should be recognized under EMIR.\textsuperscript{169} For a trade repository to be recognized, it must submit an application for recognition to ESMA, showing that it is authorized and subject to effective supervision in a third country which satisfies three conditions. First, the third country must have been declared to have legal and supervisory arrangements equivalent to EMIR under the equivalence provisions under article 75(1).\textsuperscript{170} Secondly, it must have entered into a treaty with the EU under Article 75(2) for mutual access to, and exchange of, derivatives contracts held in the third country trade repositories.\textsuperscript{171} Thirdly, the third country must have entered into cooperation arrangements with the EU under Article 75(3) for immediate and continuous access to all necessary information from the relevant third country regulatory authority.\textsuperscript{172}

As in the case of regulatory compliance mandated for CCPs, most of these conditions are beyond the control of emerging market trade repositories, which are therefore likely to not fulfil the conditions. In addition, the equivalence provisions, discussed below, are difficult for third country emerging market regulators to comply with.\textsuperscript{173} This has been discussed in further detail in section 4.

\textsuperscript{168} \textit{Ibid}. Some of the risks inherent in Trade Repositories include: legal risk (e.g. that the TR’s novation or trade compression processes will have no legal effect); operational risk (caused by unreliable and insecure systems, controls and procedures); and, data inaccuracy, loss and leakage. See International Organization of Securities Commissions Bank for International Settlements (ed), \textit{Considerations for Trade Repositories in OTC Derivatives Markets - Consultative Report} (Bank for International Settlements 2010).

\textsuperscript{169} Article 77 of EMIR (n 3).
\textsuperscript{170} \textit{Ibid}.
\textsuperscript{171} \textit{Ibid}.
\textsuperscript{172} \textit{Ibid}.
\textsuperscript{173} Article 13(2) of EMIR (n 3).
3.3. Application of EMIR Equivalence Provisions to Third Country Derivatives Regulatory Regimes

As indicated in the respective provisions covering third country CCPs and trade repositories, EMIR creates certain obligations that third country legislators, policy makers and regulatory authorities are bound to effect, if the third country CCPs and trade repositories are to provide regulated services to EU-regulated entities.\(^{174}\) EMIR acknowledges that the effect of its extraterritoriality is to create duplicative and conflicting rules in third country regulatory frameworks, which may hamper cross-border business between EU and non-EU entities.\(^{175}\)

Article 13(2) of EMIR therefore provides that the Commission may make an “equivalence decision”, by declaring that the “legal, supervisory, and enforcement arrangements” of a third country: are equivalent to the clearing, reporting, clearing thresholds, and risk mitigation requirements under EMIR; are equivalent to the rules on protection of professional secrecy under EMIR; and are “being effectively applied and enforced in an equitable and non-distortive manner so as to ensure effective supervision and enforcement in that third country”.\(^{176}\)

According to the EC, the main aim of the equivalence provisions is to push third country policy makers and regulators to reform their OTC derivatives regulations, and to delegate EU regulators’ responsibilities over third country regulated entities to third country regulators, thereby containing regulatory arbitrage and risk contagion to EU derivatives markets.\(^{177}\) However, other commentators argue that the extraterritoriality of EMIR is a new effort at regulatory imperialism, spurred by the EU’s increased regulatory capacity, and aimed at easing competition with offshore financial centres capitalizing on regulatory arbitrage.\(^{178}\)

Aside from the ideological problems with regulatory unilateralism especially by the US and EU, considering their respective economies’ role in the 2008 global

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\(^{174}\) See Articles 13 (2), 25 and 77 of EMIR (n 3). See also, COM (2010) 484 (n 6) 15; ‘COM (2010) 484 ’ (n 6) 15; Alexander and Dhumale (n 110).

\(^{175}\) Recital 6 of EMIR (n 3).

\(^{176}\) Article 31 of EMIR (n 3).

\(^{177}\) COM (2010) 484 (n 6) 15.

\(^{178}\) Charles (n 158); Moloney (n 158); Quaglia (n 158).
financial crisis, the main issue with this type of legal transplantation is its disruptive
effect on third country emerging economies’ development policies and regulatory
programmes and priorities. A significant question (discussed further below) is
whether systemic risk and compliance with EMIR is as pressing a regulatory
concern for emerging market regulators, as is the building of liquid and vibrant
OTC derivatives markets, which is currently their main regulatory concern.

IV. THE IMPACT OF EXTRATERRITORIALITY OF EMIR ON DERIVATIVES
MARKETS IN THIRD COUNTRY EMERGING MARKETS

4.1. THE CONDITIONS OF DERIVATIVES MARKETS IN EMERGING ECONOMIES

To appreciate the impact of EMIR on third country emerging markets, and the
relevance of the three-tier proportionality test, their OTC derivatives markets
should be placed in context. There is no common definition of emerging markets,
even though they share at least five common attributes: they are transitional market
economies, with a lower level of development than developed countries, and which
exhibit high volatility, high growth rate, and a big capacity for future growth
into developed economy status. Emerging market derivatives sectors are relatively
underdeveloped, due to poorly developed spot markets, fragmented agricultural
markets, and low, untradeable product volumes.

In addition, since these markets are predominantly domestic markets, there is
lower demand for hedging instruments. This, coupled with low investor
awareness, market expertise and technical capacity, has resulted in low liquidity
for contracts issued to the market. The lack of homogenous products that are
also compatible with global OTC market standards has also prevented emerging

179 Ghouri (n 10).
180 Ibid.
181 Aziz Sunje and Civi Emin, ‘Emerging Markets: a Review of Conceptual Frameworks’ in
Proceedings of the First International Joint Symposium of Business Administrator: Challenges
for Business Administrators in the New Millennium (Canakkale Onsekiz Mart Universitz,
Silesian University, 2008).
182 George Tsetsekos and Panayotis N Varangis, The Structure of Derivatives Exchanges: Lessons
183 Ibid.
184 Ibid.
markets from growing the size of their OTC derivatives markets. In addition, there are sub-optimal legal and regulatory frameworks for derivatives trading, and a lack of market infrastructures which further undermine the development of the derivatives sector in general.

The resurgence of emerging markets over the last decade, and their increased participation in global, cross-border financial services, has encouraged efforts by various local and international partners to set up formal derivatives markets in these emerging markets. In view of their novel challenges amid global competition, experts have repeatedly proposed novel approaches to setting up sustainable derivatives trading in emerging markets. These approaches include linkages with developed derivatives markets to increase market liquidity, designing and issuing of bespoke contracts that serve the unique needs of specific markets, and establishment of a cost-effective legal and market infrastructure.

Whether the national, international or extraterritorial legal and regulatory frameworks applicable to these emerging markets allows for or inhibits these novel approaches will therefore determine the extent of growth of these emerging market OTC derivatives markets.

The International Organization of Securities Commissions (IOSCO) recognizes at least 26 countries with OTC derivatives markets at various levels of development, as emerging markets. They include EU countries such as Romania, Macedonia, Poland, Czech Republic, Turkey and Slovenia. Latin America is represented by Colombia, Brazil, Argentina, Panama, Costa Rica, Chile, and Barbados. Asian

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186 Ibid.
189 Ibid.
190 ‘IOSCO Emerging Markets Committee Report FRG7/10’ (n 101).
emerging markets include India, Pakistan, Korea, China, Chinese Taipei, Malaysia and Bangladesh. Africa is represented by South Africa and Kenya.\footnote{Ibid.}

It is important, however, to take note of the wide differences between economically and politically dominant emerging market countries such as Brazil, Russia, India, China, and South Africa (touted as the BRICS countries), and smaller emerging market countries such as Kenya, Nigeria, Pakistan, Colombia, among others. The arguments explored here are more relevant to the latter set of emerging market countries, than the BRICS countries.

The size of the global OTC derivatives market, as of 2013, was about 693 trillion dollars in outstanding notional amounts.\footnote{BIS, ‘OTC Derivatives Statistics as at End-June 2013’ (Bank for International Settlements 2013) <http://www.bis.org/publ/otc_hy1311.pdf> accessed 7 August 2015.} Most of the trades are based in London and New York, while the rest are based in the EU, Asia Pacific and Latin America.\footnote{‘IOSCO Emerging Markets Committee Report FR07/10’ (n 101) 8.} Emerging markets account for only about 3.588 trillion dollars out of the global total, representing less than 0.5% of the global OTC derivatives markets.\footnote{Ibid.} With these figures in mind, it is worth considering whether or not this OTC market size is systemically significant in terms of contagion or systemic risk threatening the EU OTC derivative market, to warrant extraterritorial OTC derivatives markets regulations such as EMIR.

Majority of the OTC derivatives contracts traded globally, especially in the US and the EU, are interest rate derivatives and Credit Default Swaps (CDS).\footnote{‘BIS OTC Derivatives Statistics Report 2013’ (n 191).} It is these CDS contracts that were largely blamed for aggravating the global financial crisis in 2008.\footnote{Jackson and Miller (n 13) 3.} On the other hand, most of the contracts traded in emerging markets are foreign exchange contracts (41%), interest rate derivatives (30%) and commodity derivatives (29%), all of which are used predominantly for hedging purposes. CDS contracts account for less than 5%.\footnote{‘IOSCO Emerging Markets Committee Report FR07/10’ (n 101) 8; Ehlers and Packer (n 186).} It is for this reason that emerging markets were hardly affected by the credit crisis that spread from the...
US sub-prime mortgage sector into Europe.\textsuperscript{198} Indeed, there were no reported cases of the collapse of systemically important financial institutions (SIFIs) in emerging markets.\textsuperscript{199}

An argument can be advanced that, considering the comparatively smaller size and place of the third country emerging economies’ OTC derivatives markets within the global OTC derivatives market, any attempts by the EU to regulate these third country markets must be grounded on sound regulatory rationale based on a cost-benefit analysis that reveals surplus regulatory welfare in favour of these emerging markets.\textsuperscript{200} The EU, in its impact assessment, disagrees with this view on three fronts. First, since the OTC derivatives market is inter-connected, all derivatives played a role. Secondly, issues affecting the CDS sector can equally crop up in other derivatives sectors. Lastly, regulation should be futuristic rather than reactionary, and should aim to fix both current and future anticipated regulatory problems.\textsuperscript{201}

While this rebuttal may be compelling for EU and developed third country OTC derivatives markets, it does not make a good case for assertion of extraterritorial jurisdiction in emerging markets, from the perspective of the proportionality doctrine. This is especially the case where EMIR does not sufficiently balance the benefits of extraterritorial regulation with the costs to these third countries.\textsuperscript{202} With the benefit of the above context, the following section briefly examines the impact of EMIR on third country emerging economies’ OTC derivatives markets.

\textbf{4.2. The Impact of EMIR on Third Country Emerging Economies’ OTC Derivatives Markets}

In most national and regional legislative processes, any legislative project must take into account a cost-benefit analysis of the proposed regulation, and weigh the costs of regulation against anticipated benefits.\textsuperscript{203} For extraterritorial legislations such as EMIR, the discussion under section 3.1 has laid a legal case for the assessment

\begin{itemize}
  \item \textsuperscript{198} Ibid.
  \item \textsuperscript{199} Ibid.
  \item \textsuperscript{200} Vranes (n 9) 96; Greene and Potiha (n 30) 293.
  \item \textsuperscript{201} ‘COM (2010) 484’ (n 6) 60.
  \item \textsuperscript{202} Vranes (n 9) 96; Greene and Potiha (n 30) 293.
  \item \textsuperscript{203} Ibid.
\end{itemize}
of the suitability, necessity and balance achieved by a law, as between the enacting state and the third countries.

In the case of EMIR, various impact assessments by the European Commission, EU national regulators, international and third country regulators and market participants, have highlighted varying degrees of impacts of its extraterritoriality on third country emerging markets. These include regulatory conflicts, increased regulatory compliance costs, increased regulatory reform, supervision and enforcement costs, decreased market liquidity, market disruption, increased concentration risk and systemic risk, and stifled development of emerging economies’ OTC derivatives markets. I discuss each of these impacts below.

While these impact assessments provide valuable reference points, it is necessary to bear in mind the potential for the promotion of self-serving agenda by way of information dissemination campaigns, as is common with a polycentric sphere of regulatory activity. Hence this discussions attempts a conscious aggregation of the views of various competing constituencies: the European Commission, EU

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205 Ibid.

national regulators, international and third country regulators, and market participants.

4.2.1. CONFLICT BETWEEN EMIR, US DODD-FRANK ACT AND THIRD COUNTRY LEGISLATION

A major concern of EMIR’s extraterritoriality is its conflict with existing third country OTC derivatives and general securities regulations. CCPs, trade repositories and trade counterparties are subjected to at least two conflicting sets of regulations.\(^{207}\) For example, the data protection laws of China and Korea restrict transmission or reporting of derivatives trades particulars, in conflict with EMIR reporting obligations.\(^{208}\) This problem is exacerbated by the fact that the US has also enacted the Dodd-Frank Act, whose Title VII provisions on regulation of swap counterparties and CCPs are also extraterritorial, and which conflict with EMIR.\(^{209}\) This includes the application of the clearing obligation to certain derivatives contracts and non-financial Counterparties, margin and collateral risk mitigation rules, registration of dealers and CCPs, and reporting requirements.\(^{210}\)

There is concern from regulators (including the FSB), industry groups (such as GFMA and ISDA), and other observers, that duplicative and conflicting legislation will make third country market participants less competitive than EU market participants, create uncertainty and regulatory anxiety, and undermine business confidence.\(^{211}\) This is detrimental to developing OTC derivatives markets. In addition, third country regulators will be constrained to supervise and enforce compliance with both EMIR and local legislation, to enable third country market participants to access EU markets. This undermines the third countries’ sovereignty.

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\(^{207}\) Mauricio Salazar, ‘Swapping More than Regulations: Reexamining the Goals of the Dodd-Frank Act and the European Market Infrastructure Regulation on Over-the-Counter Derivative Markets’ (2014) 21 Southwestern Journal of International Law 217, 232; Greene and Potiha (n 30); Lüttringhaus (n 2).

\(^{208}\) ‘GFMA, Impact of EU Extraterritorial Legislation on Asian Markets’ (n 203).

\(^{209}\) Greene and Potiha (n 30); Lüttringhaus (n 2); Coffee (n 33); Salazar (n 206).


\(^{211}\) ‘GFMA, Impact of EU Extraterritorial Legislation on Asian Markets’ (n 203); ‘Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences’ (n 22).
and derails their economic and regulatory policies and goals.\textsuperscript{212} While it is necessary to keep in mind the industry groups’ narrow interests and motivations in lesser regulation of financial markets, these critiques of EMIR have exposed regulatory concerns that have been echoed by emerging market regulators, but perhaps lessconcertedly.\textsuperscript{213}

In response to this criticism, EU policy makers, regulators and various commentators have argued that these effects are inevitable and necessary to push third countries to reform their OTC derivatives laws, prevent regulatory arbitrage, and arrest risk contagion from the third countries.\textsuperscript{214} They also argue that the equivalence provisions under Article 13 resolve the regulatory conflict problem.\textsuperscript{215} Since 2011, as a result of calls by industry players and EU regulators, there have been various consultations between EU and US regulators, to reconcile the differences between EMIR and Title VII. The proposed principal methods of resolving the extraterritoriality difficulties are equivalence and mutual recognition frameworks.\textsuperscript{216}

The equivalence provisions hardly mitigate the problem and effects of regulatory conflict, since they require a third country to duplicate EMIR to the letter. For example, in the first equivalence evaluation of the US OTC derivatives regime, ESMA found the Dodd-Frank Act to be non-compliant, despite the latter being more stringent.\textsuperscript{217} In addition, Article 13 provides that third country legislation should be “equitable and non-distortive” to EU firms by not saddling them with regulatory obligations in conflict with or more onerous than EMIR.\textsuperscript{218}

\textsuperscript{212} ‘FSB Peer Review of South Africa, February 2013’ (n 203).
\textsuperscript{213} ‘IOSCO Emerging Markets Committee Report FR07/10’ (n 101) 33.
\textsuperscript{214} ‘COM (2010) 484’ (n 6); Quaglia (n 158); Moloney (n 158).
\textsuperscript{215} ‘COM (2010) 484’ (n 6); ‘GFMA, Impact of EU Extraterritorial Legislation on Asian Markets’ (n 203).
\textsuperscript{216} In July 2013, the US and EU entered negotiations on the TransAtlantic Trade and Investment Partnership (TTIP), the largest Free Trade agreement in the world, including in financial services, thereby becoming a global regulatory standard-setter. See Brett Bickel, ‘Harmonizing Regulations in the Financial Services Industry through the Transatlantic Trade and Investment Partnership’ (2014) 29 Emory International Law Review 557, 558.
\textsuperscript{218} Article 13 of EMIR (n 3).
Moreover, equivalence decisions are dependent on treaty negotiations and subsequent equivalence assessments, which are outside of the influence of market players.\textsuperscript{219} In addition, even where EU and US regulators agree on a common mutuality framework for non-EU and non-US third countries, the problems posed by EMIR’s extraterritoriality persist: intrusive conflicting regulations that undermine national regulatory goals, duplicative and costly regulations, and unnecessarily onerous regulatory burdens on less risky emerging markets.\textsuperscript{220}

It is also instructive to note that the EC’s official impact assessment report for EMIR does not consider or discuss the conflicts between EMIR and third country legislation.\textsuperscript{221} To this extent, it is questionable whether EMIR can be deemed to have fulfilled expectations of the proportionality doctrine.

\textbf{4.2.2. Unduly Onerous Regulatory Compliance Costs}

EMIR has significantly increased the cost of regulatory compliance for both EU and third country derivatives market players, but with more detrimental impacts for emerging markets. These include costs of installing new, automated operational systems, especially for risk mitigation and standardization of trade processes for uncleared trades, costs of complying with multiple derivatives regulations, clearing costs, and capital costs incurred in additional collateral requirements.\textsuperscript{222} According to one study by Deloitte UK, which made use of, among others, BIS, IOSCO, and ESMA impact assessments, the estimated additional cost for centrally cleared OTC derivatives transactions (per Euros 1 million notional amount traded, basis

\textsuperscript{219} Cynthia Tang, Bryan Ng and Eric Chan, ‘Bumps on the Path Forward - Does the Transatlantic OTC Derivatives Debate Need a New Direction’ (2013) 32 International Financial Law Review 39; Bickel (n 215); Salazar (n 206).

\textsuperscript{220} Nusret Cetin, ‘Legal Reforms in the Aftermath of the Financial Crisis: Opportunities and Challenges for Emerging Market Economies’ (Social Science Research Network 2012) SSRN Scholarly Paper ID 2246598; Prasad (n 8).

\textsuperscript{221} ‘COM (2010) 484’ (n 6).

points) is Euro 13.60 (0.136 bps), while that of non-centrally cleared OTC derivatives contracts is Euros 170.50 (1.705 bps).

The implications are that market participants will withdraw from the emerging economies’ OTC derivatives markets, due to shrinking revenue or losses in certain trades, resulting in low liquidity and less vibrant markets. Secondly, industry groups also observe that onerous regulatory costs on emerging markets increase hedging costs for emerging market end-users, where these risk mitigation instruments are integral for trading in volatile commodity markets. This threatens emerging markets’ fragile economies and commodity markets. While it must be borne in mind that industry lobby groups are usually consistent in pushing back financial regulations, especially on grounds of increased regulatory costs, it is important to examine whether the additional costs are proportionate to the regulatory welfare for the industry.

EU regulators and policy makers justify the additional regulatory costs as necessary short-term costs that are small in comparison to the long-term benefits of stable and safer global OTC derivatives markets. In addition, they contend that increased hedging costs are a correction of the mis-pricing of various risks. This policy rationale, however, does not apply to emerging markets, to the extent that they do not register a net benefit from EMIR’s main regulatory welfare. Some international financial regulators agree. For example, while the Bank for International Settlement (BIS) argues that the regulatory compliance costs are offset by the benefits of market stability, it admits that these benefits may not equally reflect in emerging markets.

224 Ibid.
226 Ibid.
228 Ibid.
229 ‘Macroeconomic Impact Assessment of OTC Derivatives Regulatory Reforms’ (n 221).
The issue this argument presents is the trade-off between systemic risk and financial markets development. What is the level of urgency requiring the application of such onerous extraterritorial regulations against nascent, unthreatening EMDE derivatives markets? While market development and containing systemic risk may not necessarily be mutually exclusive concerns, it could be argued that sequencing onerous, pre-emptive financial stability measures before certain market development strategies puts paid to the latter’s viability. 230

Since financial market development strategies always embody a level of risk, the trade-off or delicate balance is usually consciously made by national regulators in respective national macroeconomic policy frameworks. 231 Indeed, financial stability achieved should be a balance between risk and financial markets development. 232 Hence the unilateral nature of EMIR attracts the critique that it fails to balance the regulatory benefits of safer and more stable EU and other third country derivatives markets, with the regulatory costs incurred by the third countries in implementation.

3.2.3. Decreased Liquidity/Global Flow of Capital into Third Country Emerging Markets

Increased cross-border capital flows and trade liberalization has opened up emerging economies’ derivative markets to EU and US financial institutions, which dominate domestic and cross-border transactions in Asian and other emerging markets. 233 Increased and onerous cross-border regulatory costs on both EU and non-EU entities may result in EU clearing members withdrawing from third country CCPs due to non-compliance, and also from transacting with non-EU counterparties that are non-compliant with EMIR obligations such as trade

This may have an adverse impact on the inflow of finance from EU markets to emerging markets, and therefore a liquidity crunch. Most of the EU entities are therefore considering establishing subsidiaries in these markets. However, subsidiaries would still be less capitalized than the parent companies, thereby resulting in less liquidity in these derivatives markets.

The EC EMIR impact assessment report and subsequent policy papers have not addressed the deterrence that EMIR creates for cross-border trades with emerging markets. Since the strategies of most emerging economies’ derivatives market regulators depend on international linkages to boost liquidity in their markets, EMIR poses a significant hurdle, and therefore lacks interest balancing.

4.2.4. Market Disruption, Fragmentation, Increased Systemic Risk and Obstruction of Development of OTC Derivatives Markets in Emerging Economies’

As discussed above, EU regulators and policy makers cite the need to contain regulatory arbitrage and contagion from third countries as justification for EMIR’s extraterritoriality. However, EMIR does not consider the characteristics and level of development of OTC derivatives markets in emerging economies. The onerous compliance costs, withdrawal of EU entities from third country derivatives markets, and the subsequent liquidity shocks are expected to have a disruptive effect on the third country emerging economies’ OTC derivatives markets, resulting in market instability. Critics of EMIR have also argued that the mandatory clearing by CCPs will increase concentration risks in small economies, in the event that the CCPs experience financial problems. In addition, the complex, conflicting

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234 ‘GFMA, Impact of EU Extraterritorial Legislation on Asian Markets’ (n 203); ‘Macroeconomic Impact Assessment of OTC Derivatives Regulatory Reforms’ (n 221).
235 Ibid.
236 ‘GFMA, Impact of EU Extraterritorial Legislation on Asian Markets’ (n 203) 3.
237 Ibid.
239 Cetin (n 219).
241 ‘FSB, Monitoring the Effects of Agreed Regulatory Reforms on Emerging Market and Developing Economies 2013’ (n 203).
242 Murphy (n 116); Alexander and Dhumale (n 110); Gregory (n 104).
legislation that third country emerging markets are subjected to may actually increase systemic risk, since it will be difficult for third country regulators to monitor and capture activity in these markets.\textsuperscript{243}

Another systemic risk concern is the endogenous risk.\textsuperscript{244} Where all the global OTC derivatives market players and regulators play according to identical rules, there is an even greater contagion risk, and concentration risk.\textsuperscript{245} This is especially where a particular regulatory action or remedy (such as EMIR) is ill-advised.\textsuperscript{246} EMIR’s equivalence provisions therefore takes away the safety net of regulatory competition that emanates from different, contextualized regulatory actions.\textsuperscript{247}

More importantly, international regulators such as the FSB have noted that the increased regulatory compliance costs, additional risk mitigation measures, and the attendant liquidity and market disruption effects will hamper the development of derivatives and capital markets in some emerging markets.\textsuperscript{248} One effect, for

\textsuperscript{243} See generally, Tang, Ng and Chan (n 218); Salazar (n 206); Bickel (n 215). For a review of the effects of the reforms in the South African OTC Derivatives markets, see ‘FSB Peer Review of South Africa, February 2013’ (n 203).

\textsuperscript{244} Endogenous risk refers to the risk from shocks generated and amplified within the financial system, by identical reactions of market participants to a market event. See Jon Danielsson and Hyun Song Shin, ‘Endogenous Risk’ in Peter Field (ed), Modern Risk Management: A History (Risk Books 2003) 297; Emilios Avgouleas, Governance of Global Financial Markets: The Law, the Economics, the Politics (Cambridge University Press 2012) 244.


\textsuperscript{246} See Slavisa Tasic, ‘The Illusion of Regulatory Competence’ (2009) 21 Critical Review 423. Regulators may make wrong regulatory policies reinforced by the illusion of their regulatory competence and biases, and which are only unravelled by major financial crises such as the 2007 global financial crisis.

\textsuperscript{247} While regulatory cooperation is necessary, a level of policy differentiation is also necessary. See AO Sykes, ‘Regulatory Competition or Regulatory Harmonization? A Silly Question?’ (2000) 3 Journal of International Economic Law 257. For example, regulatory competition and harmonization can be seen as complements rather than supplements. See Jeanne-Mey Sun and Jacques Pelkmans, ‘Regulatory Competition in the Single Market’ (1995) 33 JCMS: Journal of Common Market Studies 67.

\textsuperscript{248} ‘FSB Peer Review of South Africa, February 2013’ (n 203); ‘FSB, Monitoring the Effects of Agreed Regulatory Reforms on Emerging Market and Developing Economies 2013’ (n 203).
example, is that EMIR will hamper the development of homogenous derivatives contracts, which may be necessary for emerging economies’ commodity markets with market needs that do not fit globally standardized contract volumes and commodity characteristics. In addition, as discussed above, third country CCPs, trade repositories, issuers and counterparties may be locked out of the EU market, which is a significant source of liquidity for emerging markets.

EU policy makers’ argument that the long-term market stability benefits of EMIR are greater than the costs to third country markets cannot be taken at face value, since there is no evidence of the EC or other EU regulators conducting extraterritorial impact assessments of EMIR. On the other hand, impact assessments undertaken by regulators and industry so far argue otherwise. It should, however, be noted that most of these studies are preliminary, since there is insufficient data to examine the impact of regulatory implementation over an appropriate period of time. EMIR, nevertheless, does not answer questions as to its cost-benefit utility, in respect of third countries, and fails to make an effort to balance the interests of the EU and third country emerging markets.

In the present international law framework on extraterritorial legislation, it is unlikely that the US and EU would take into account third country concerns, as both jurisdictions are accountable to their respective domestic constituencies only. Hence the need for third country advocacy on their concerns. Some potential strategies are considered below.

V. Proposals for Reform in the Use of Extraterritorial EU OTC Derivatives Market Regulations

The foregoing discussion has laid a basis for the re-examination of the legality of the extraterritorial provisions of EMIR. This situation therefore requires a review and reform in how regional and national OTC derivatives markets regulators assert extraterritorial jurisdiction to reign in systemic risk and financial instability in the global markets. The following are proposed starting points in a conversation among emerging markets, on strategies for reviewing EMIR and other extraterritorial OTC derivatives regulations.

249 Ibid. See also, ‘Macroeconomic Impact Assessment of OTC Derivatives Regulatory Reforms’ (n 221).
250 Ibid.
4.1. Affirming and Modernizing International Law and Principles of Extraterritorial Jurisdiction

Due to the split juridical opinion on its place in international law, and the increasing use of extraterritorial regulations by the EU and US, and potentially other competitive financial centres, the doctrine of proportionality of extraterritorial legislation requires to be formally anchored in international law. Regulators and market participants, especially from third countries, should endeavour to promote the proportionality doctrine as international law by instituting international proceedings on improper assertion of extraterritorial jurisdiction at the ICJ. They can also influence international customary law by way of diplomatic protests, blocking statutes, claw-back statutes, and judicial measures.

In addition, State-to-State groups of EMDEs should lobby for soft law financial standards formulated at international regulatory forums such as the Basel Committee, FSB and IOSCO, to recognize and promote the doctrine of proportionality as an essential element of valid assertion of extraterritorial jurisdiction, especially in regulation of global markets such as OTC derivatives markets. Once the requirement is formalized in international law, extraterritorial legislation grounded on various lawful rationale will be more legitimate, enforceable and acceptable in the global financial markets, including emerging markets.

251 Dallara (n 2); Ryngaert (n 60); Meessen (n 67); Bourgeois (n 68).
252 ‘UN Doc A/61/10’ (n 44) 529. However, private actors and civil society are more willing than States to engage in international litigation against other States, since this invites a scrutiny of the initiating State’s own adherence record to international law. The dependence of EMDEs on aid and grants from the US and EU also discourages litigation against the latter. See Karen J Alter, The New Terrain of International Law: Courts, Politics, Rights (Princeton University Press 2014) 7.
253 ‘UN Doc A/61/10’ (n 44) 529. These strategies, however, depend on the relative power of the relevant markets. For example, a small developing country’s blocking statute is of no consequence to the EU market as compared to, for example, China’s blocking Statute.
4.2. **Benchmarking of Extraterritorial Legislation by Transnational Financial Regulators**

Unilateral EU and US extraterritorial legislation, especially on banking and derivatives sectors, have overshadowed and undermined transnational regulatory approaches that would have been more sensitive to issues in both emerging and developed derivatives markets.\(^{255}\) EU and US regulators, policy makers and analysts in support of extraterritoriality have, however, criticized the transnational regulatory approaches as too slow, and whose regulatory outputs are too generalized, weak, and ineffective.\(^{256}\) While these criticisms are valid, the hegemonic interests of the US and the EU, and their aversion to multilateral financial regulatory forums such as the World Trade Organization (WTO) must be borne in mind.\(^{257}\) Nevertheless, multilateral negotiation of certain global financial regulatory standards such as Basel III has been successful, and especially to the extent that emerging market concerns have informed the final standards.\(^{258}\)

The engagement of broad-based and inclusive international regulators such as the FSB, Basel Committee and IOSCO (especially since 2009) may provide a credible peer review forum that can competently engage with legislating countries in considering and mitigating negative impacts of extraterritorial OTC derivative legislation.\(^{259}\) They can also create and promote the adoption of harmonization frameworks that are sensitive to both developed and emerging markets.\(^{260}\) However,

\(^{255}\) Dallara (n 2); Greene and Potiha (n 30); Coffee (n 33).

\(^{256}\) Bickel (n 215) 570; Coffee (n 33). For example, the US and EU regulators have adopted banking regulatory standards that are more stringent than Basel III.


\(^{259}\) So far, the FSB has consistently addressed the intended and unintended consequences of US and EU extraterritorial legislation in its reports to the G20. See ‘Monitoring the Effects of Agreed Regulatory Reforms on Emerging Market and Developing Economies (EMDEs)’ (n 257).

\(^{260}\) Dallara (n 2) 56.
there is need to keep in mind the pervasive hegemony of US and other G-7 countries in the transnational regulatory networks, which may still tilt the contributions of these transnational regulators in favour of unilateral extraterritorialism.261

4.3. REQUIREMENT FOR GLOBAL MARKET REGULATORY IMPACT ASSESSMENTS

A more specific regulatory reform measure for the assertion of extraterritorial jurisdiction by national financial legislations is obliging the enacting States’ regulators and policy makers to undertake a global market regulatory impact assessment.262 Regulatory impact assessments should typically outline the policy and regulatory justifications, the logic and methodology, the various alternatives to, and the impacts of the proposed extraterritorial measures, in respect of all affected jurisdictions.263 In accordance with the first two proposals, the regulatory impact assessments should measure and make recommendations on a proposed extraterritorial law’s compliance with the doctrine of proportionality.264

In addition, this regulatory impact assessment should have the input of transnational regulators such as the FSB, which have the benefit of a global perspective of the global OTC derivatives and entire financial markets. It should also have the input of affected third parties, including third country regulators, policy makers and market participants.265 A properly structured international legislative framework for extraterritorial legislation will streamline such a demanding process into an efficient and less costly regulatory impact assessment exercise. The consequence of non-compliance with the global market regulatory impact assessment should be the judicial and political invalidation of the enactment, or further negotiations and review of a proposed measure.266

261 Verdier (n 256); Beeson and Bell (n 256).
262 See, for example, the suggestion by the financial services industry to US and EU regulators in GFMA and others to US Treasury Secretary and EU Commissioner for Internal Markets and Services, ‘Extraterritorial Legislation: The Problems Posed for Markets, Clients and Regulators’ (19 April 2012) <trade.ec.europa.eu/doclib/html/149702.htm> accessed 7 September 2015.
263 For an overview of regulatory impact assessment, see generally, CH Kirkpatrick and David Parker, Regulatory Impact Assessment: Towards Better Regulation? (Edward Elgar Publishing 2007).
264 Vranes (n 9). For a general overview of the policy trade-offs involved, see generally, Diana Fuguitt and Shanton J Wilcox, Cost-Benefit Analysis for Public Sector Decision Makers (Greenwood Publishing Group 1999).
265 Dallara (n 2) 58.
266 See the previous discussion on State litigation as a strategy, in ‘UN Doc A/61/10’ (n 44) 529; Alter (n 251) 7.
This reform proposal, of course, encounters cooperation challenges from third countries that may not see the net benefit of extraterritorial measures where, for example, they benefit from regulatory arbitrage. In addition, regulatory impact assessment as a transnational policy itself encounters difficulties of adoption and implementation, especially by the hegemonic powers in international finance, such as the US and other G7 countries, which wield unilateral powers in transnational economic governance.

4.4. REGULATORY EXEMPTIONS

The outcomes and recommendations of a global market regulatory impact assessment exercise, in respect of emerging markets, should be regulatory exemptions for certain jurisdictions, regulators, and market participants. In essence, extraterritorial legislation should integrate the special and differential treatment (SDT) principle that has guided the vesting and implementation of obligations in international trade agreements under the WTO treaties. For example, market participants, regulators and regulatory regimes from under-developed jurisdictions in emerging markets, which do not pose significant systemic risk to the EU financial markets, and which will be adversely affected by EMIR’s extraterritorial obligations, should be exempted from those obligations, as long as these conditions persist.

Considering that most emerging market OTC derivatives regulators outside of the G20 have declared willingness to implement the G20’s OTC derivatives reform recommendations, these regulatory exemptions should merely give them regulatory space to undertake sustainable and effective regulatory reforms. In addition, the exemptions will mitigate the negative effects that may hinder the development of derivatives markets in these emerging market economies.

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268 Dallara (n 2) 58; Greene and Potiha (n 30) 293.


270 Ibid.

271 ‘IOSCO Emerging Markets Committee Report FR07/10’ (n 101).

272 Cetin (n 219).
4.5. Mutual Recognition, Substituted Compliance and Equivalence Regimes

Another proposed reform measure to the implementation of EMIR’s extraterritorial provisions, where exemptions may not be efficient, is to introduce mutual recognition, substituted compliance or equivalence regimes in respect of third country emerging market OTC derivative regulatory regimes. These equivalence regimes should be different from EMIR’s equivalence regime, and Dodd-Frank’s substituted compliance regimes, to the extent that the proposed regimes should consider the effect of the third country regulation, rather than whether it conforms to the legislative letter of EMIR or Dodd-Frank.

If such an equivalence regime is implemented, it will resolve the problems of conflict between EMIR and the third country regulation, uncertainties of third countries implementing many conflicting extraterritorial legislations, regulatory duplication, increased compliance costs, and inefficient implementation of EMIR through economic duress. In addition, it will give third countries the space to formulate OTC derivatives policies and regulations that conform to both a third country’s economic blueprints, and EMIR’s regulatory objectives, mainly that of containment of contagion from third country markets.

VI. Conclusion

The main question that this study has considered is the impact of EMIR’s extraterritorial provisions on third country emerging economies’ OTC derivatives markets. EMIR has applied the CCP clearing, trade reporting and risk mitigation obligations to both EU and non-EU central counterparties, CCPs and trade repositories. In addition, its equivalence regime mandates third country regulators to reform their OTC derivatives regulatory regimes to reflect EMIR’s requirements, if the third country’s CCPs and trade repositories are to access EU markets.

These extraterritorial provisions are expected to have adverse effects on nascent, emerging economies’ OTC derivatives markets, since these markets are underdeveloped, illiquid, and rely extensively on liquidity and market infrastructure from EU and other developed OTC derivatives markets. The study has adopted the three-tier proportionality doctrine proposed by Vranes, to assess whether the regulatory benefits of EMIR’s extraterritorial provisions are
suitable, necessary, and balanced, and whether assertion of extraterritorial jurisdiction under EMIR is justified.  

The discussion concludes that while the CCP clearing, reporting and risk mitigation measures are effective, they are not suitable or necessary to most emerging economies’ OTC derivatives markets. This is because these markets are insignificant in size (less than 0.5% of the global OTC derivatives market), and do not trade much in CDS contracts, which were blamed for accelerating the 2008 financial meltdown. In addition, the emerging economies’ OTC derivatives markets remained largely stable during the financial crisis.

EMIR also fails to balance the benefits of reigning in contagion from third country emerging markets, against the immense and unequal costs incurred by third countries in implementing its provisions. These costs include regulatory conflicts causing derailment of third country economic development policies and market uncertainty, increased regulatory compliance costs, reduced liquidity through withdrawal of both EU and non-EU liquidity providers from third country derivatives markets because of high compliance costs and non-compliance.

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273 Greene and Potiha (n 30) 293.
274 ‘GFMA, Extraterritoriality Issues in US and EU’ (n 216); ‘GFMA, Impact of EU Extraterritorial Legislation on Asian Markets’ (n 203).
275 Ibid.
276 Cetin (n 219).
277 Articles 4, 9, 11, 13, 55 and 77 of EMIR (n 3).
278 Dallara (n 2); ‘Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences’ (n 22); ‘Macroeconomic Impact Assessment of OTC Derivatives Regulatory Reforms’ (n 221).
279 Vranes (n 9) 95.
281 Ibid.
282 ‘Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences’ (n 22); Dallara (n 2); ‘OTC Derivatives - The New Cost of Trading’ (n 222); ‘Macroeconomic Impact Assessment of OTC Derivatives Regulatory Reforms’ (n 221).
283 See generally, the discussion under section 4 above.
284 Ibid.
Other costs include increased regulatory risks and endogenous risks caused by adoption of EMIR regulatory frameworks under economic duress, market disruption, fragmentation, and increased systemic risk. These costs ultimately act as barriers to the development of nascent emerging economies’ OTC derivatives markets, most of which are still nascent and poorly developed, and have traditionally relied on EU and US markets for liquidity and market infrastructure.

In a global financial regulatory market increasingly characterized by extraterritorial legislation adverse to third country emerging markets, there is a need for at least six measures to curb invalid assertion of extraterritorial jurisdiction. First, third country regulators, international regulatory bodies, and global market participants must work together to elevate the doctrine of proportional assertion of extraterritorial jurisdiction in international law. Secondly, international regulatory forums such as the G20, Basel Committee, FSB, IOSCO, IMF and the World Bank should increasingly work with the EU and US regulators, to ensure that much needed extraterritorial legislation are proportional. This will work towards promoting both financial stability and market development in emerging economies’ OTC derivatives markets.

Thirdly, the international regulatory frameworks should also mandate inclusive and participatory global market regulatory impact assessment exercises by states enacting extraterritorial jurisdiction, so that there is evidence of implementation of the proportionality doctrine. These impact assessment reports can then inform the implementation of two other measures - exemption measures and effects-centred mutual recognition regimes - to mitigate the negative effects of extraterritorial legislation on emerging economies’ OTC derivatives markets.

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285 Ibid.

286 ‘GFMA, Impact of EU Extraterritorial Legislation on Asian Markets’ (n 203); ‘FSB Peer Review of South Africa, February 2013’ (n 203); ‘Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences’ (n 22); ‘Macroeconomic Impact Assessment of OTC Derivatives Regulatory Reforms’ (n 221).

287 See generally, ‘UN Doc A/61/10’ (n 44).

288 Dallara (n 2).

289 Ibid.

290 ‘GFMA, Extraterritoriality Issues in US and EU’ (n 216); ‘GFMA, Impact of EU Extraterritorial Legislation on Asian Markets’ (n 203); and others (n 261).
Since EMIR and Title VII of Dodd Frank are yet to be fully implemented, assessments of their benefits and costs, especially to third countries, are merely indicative. There is need for a more inclusive policy and market research and dialogue between international and national regulators, and global market participants, to determine the accurate benefits and costs of extraterritorial OTC derivatives regulations such as EMIR. This will provide an informed basis for reviewing and reforming EMIR, to ensure that the regulatory measure contain systemic risk and market instability, while safeguarding the much-needed growth of emerging economies’ OTC derivatives markets.
Exploring Well-being and Gross National Happiness in Sustainable Development Policy Making

Donatella Alessandrini, Suhraiya Jivraj and Asta Zokaityte

ABSTRACT

In this paper we reflect on the transnational discourse on national Well-Being and Happiness (WBH) which has gained international prominence with the 2012 United Nations Conference. Although for quite some time the studies on WBH have been on the agenda of international bodies, we see the post-2007 proliferation and transnational convergence of well-being initiatives, particularly those aimed at measuring well-being through indicators, as potentially replacing the development discourse of the post-war period in terms of normative force and appeal. Aiming to unpack such normative appeal, we focus on three sites, the UK, Bhutan and Ecuador, and ask what well-being and happiness mean in each context. While a critique of growth as an end in itself appears to be common to these three sites, there are crucial differences in terms of both how Well-Being and Happiness are conceptualised, and the ways in which this understanding is able to affect policy-making and engender socio-economic change. At stake, we argue, is the appreciation of what the co-production between economic and non-economic spheres of life...
would generate. Our aim is to emphasise that, what the focus on convergence leaves out and what the turn to measurement says about the potential of well-being initiatives.

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I. Introduction

In 2012 the government of Bhutan convened a UN meeting aimed at ‘defining a new economic paradigm’ based on happiness and well-being. The key aim of the meeting was to emphasise the need for an economic paradigm that takes into account the social and environmental factors, as part of achieving sustainable development. Since then, the UN has asked the Bhutanese government to publish such a model based on their policy of Gross National Happiness which would replace the International Millennium Development Goals, ending in 2015. The Bhutanese New Development Paradigm (NDP) model was published in December 2013.\footnote{NDP Steering Committee and Secretariat, Happiness: Towards a New Development Paradigm (Report of the Royal Government of Bhutan 2013).}

In this paper we start to reflect on the transnational discourse on national Well-Being and Happiness (WBH) which has gained international prominence with the 2012 UN Conference. Although studies on WBH have been on the agenda of international bodies for quite some time, we see the post-2007 proliferation and transnational convergence of well-being initiatives, particularly those aimed at measuring well-being through indicators, as potentially replacing the development discourse of the post-war period in terms of normative force and appeal. WBH discourse is rooted historically in the acknowledgement of the limits of the growth paradigm which was central to the furtherance of the post-
colonial development enterprise. In the late 1960s and early 1970s, a critique of growth as an end of economic policies started to be voiced by the economists, psychologists, environmentalists, and feminists, who exposed GDP’s limited ability to capture people’s welfare; while dependency, post-colonial and post-development scholars showed how development itself was a construct based on powerful normative assumptions, which produced important material effects on the societies they claimed to merely describe. Attempts to incorporate some of these critiques into international policy making process included the proposition by the International Labour Organisation (ILO) of the Basic Needs Approach, the short-lived adoption of the New International Economic Order (NIEO), the adoption of the Human Development Index, the launch of the Stockholm Conference on Human Environment (the precursor to sustainable development) and the Rio Conference on Environment and Development, and the Millennium Development Goals which were established following the Millennium Summit of the UN in 2000.

It is, however, after 2007 that we have witnessed a scaling up of WBH initiatives.


reminiscent of the post-war development enterprise not only in terms of resources being invested but also of its normative appeal, which, unlike that of the post-war development enterprise, rests on the proposition of a planetary model for ‘living together’ which transcends the developed or developing lines. At a time when the financial and economic crisis has shown the weaknesses of an economic system that was presented as the harbinger of progress for over six decades, the WBH model refuses the simplistic identification of development with growth and industrialisation. At the same time it extends its focus of analysis beyond the developing world, thereby laying claims to planetary relevance. Thus, in 2011, resolution 65/309 adopted by the UN General Assembly called upon all member countries to formulate well-being measures other than GDP. The World Happiness Report, released to coincide with the UN conference, criticises the neo-classical economists’ perception of humans as rational actors, suggesting instead a different model of humanity, one in which people are bounded by a complicated interplay of emotions and rational thought, unconscious and conscious decision-making, ‘fast’ and ‘slow’ thinking, but whose common aim is to achieve well-being and happiness. According to the Report, happiness is not too subjective to be measured; and although it differs across societies and over time, it does for reasons that are identifiable, and even alterable through the ways in which public policies are designed and delivered. Given its claim to universal applicability and measurement, as well as the impetus for international and national policy-making efforts it has generated, it is our

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297 General Assembly Resolution 65/309 Happiness: towards a holistic approach to development [2011]
299 Ibid. “Studies by psychologists, economists, pollsters, sociologists, and others have shown that happiness, though indeed a subjective experience, can be objectively measured, assessed, correlated with observable brain functions, and related to the characteristics of an individual and the society. Asking people whether they are happy, or satisfied with their lives, offers important information about the society. It can signal underlying crises or hidden strengths. It can suggest the need for change.”
300 The report is co-edited by Professor Emeritus of Economics John F. Helliwell, Vancouver School of Economics, University of British Columbia, Lord Richard Layard, Director of the Well-Being Programme at the centre for Economic Performance, London School of Economics and Jeffrey D. Sachs, Director of the Earth Institute, Columbia University.
contention that WBH might well substitute itself for the development focus of the international community, or at the very least become its dominant strand in the post-2015 age. In other words, we argue that the normative appeal of WBH agenda needs to be taken seriously so as to engage with its potential as well as with its limitations. Aiming to unpack such normative appeal, we focus on three sites, the UK, Bhutan and Ecuador, and ask what WBH means in each context. While common to the three sites is a critique of growth as an end in itself, we show there are crucial differences in terms of both how well-being and happiness are conceptualised, and the ways in which this understanding in turn affects policy-making and engender social, political, and economic change. At stake, we argue, is the appreciation of what the co-production between economic and non-economic spheres of life would generate. Given the different way this appreciation plays out in the three sites, our aim is to emphasise what the focus on convergence, that is, on seeing these different experiments as part of the same phenomena, leaves out, and ask what the turn to measurement says about the potential of well-being initiatives.

The first section of the paper examines the emergence of WBH research and policy making in the UK. The reason for focusing on the UK is two-fold: firstly, the UK has only recently started measuring well-being. This is a post-2007 initiative that came out of the UN recommendation in 2012 and the Sarkozy tasked commission, which illustrates how well-being is conceived of and operationalised in a country which has been crucial for the furtherance of both the development

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301 In this paper, we use the terms ‘happiness’ and ‘wellbeing’ interchangeably. These are obviously different approaches and the weaknesses of considering them together have been noted by MacKerron. George MacKerron, “Happiness economics from 35,000 feet” (2011) 26(4) Journal of Economic Surveys 705-735. A useful typology, he points out, is offered by Dolan and others, provide for five accounts of WBH, which are: “(1) preference satisfaction, in which wellbeing consists in the freedom and resources to meet one’s own wants and desires; (2) objective lists (or basic needs), in which wellbeing is the fulfilment of a fixed set of material, psychological and social needs, which are identified exogenously; (3) flourishing (or eudaimonic), in which well-being means the realisation of one’s potential, along dimensions such as autonomy, personal growth, or positive relatedness... (4) hedonic (or affective), in which wellbeing is synonymous with positive affect balance, a relative predominance of positive moods and feelings; and (5) evaluative (or cognitive), in which wellbeing is the individual’s own assessment of his or her life according to some positive criterion”. Paul Dolan and others, Review of research on the influence of personal well-being and application to policy making (Defra,2006).
project of the post-war period and the model of financialised growth that the current crisis has called into question. The other reason concerns the fact that these initiatives are being taken at a time when austerity, with its iron laws, has been deployed as the main conceptual framework for thinking about what it means to live together in a very specific way. Keeping the tension between the well-being and austerity frameworks open is what interests us in teasing out possibilities and limitations of the WBH agenda in the UK.

The second section focuses on Bhutan where we conducted research in February 2014. We originally envisaged comparing the experience of the UK with that of the Bhutan to understand what we could learn from a country which, already in the 1970s, had rejected GDP as a measure of ‘progress’ and where, particularly after 2007, Gross National Happiness (GNH) has guided policy-making, making Bhutan the focus of international attention and the GNH laboratory for the world. However, what we have come across is a much more complex reality, where the rejection of GDP and furtherance of GNH as a new development model needs to be appreciated in light of the country’s unique history, and assumptions about the transferability of this experience are therefore problematic. While conscious of the fact that the various connections that make up Bhutan’s place in the world need to be taken into account and any simple translations be warded off, we thought it would be worthwhile to reflect on the potential as well as limitations of the new paradigm in its own right, and to show how different this is from the way WBH are understood and operationalised in the UK.

The third section focuses on Ecuador where Wellbeing (BuenVivir) has a different flavour, being presented as an alternative to development. Ecuador’s engagement with well-being policies can also be brought back to the post-2007 era when the Correa administration was elected on a broadly anti-neoliberal mandate. The administration has since attempted to formulate a conceptual framework which

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rejects the ‘modernist’ and ‘colonial’ assumptions underlying the development enterprise of the post-war period. What is interesting about Ecuador is that, even though it has undertaken efforts comparable to those of Bhutan, in terms of socio-economic legal transformations, it has not received much international attention. We explore what well-being means from the perspective of Buen Vivir and trace the commonalities and discontinuities with both the WBH agenda of the UK and Bhutan’s GNH policy.

II. Measuring Well-being and Happiness: the United Kingdom

*Social Trends* was first published over 40 years ago in the UK, with the understanding that ‘economic progress must be measured, in part at least, in terms of social benefits’ and the fact that ‘it is just as important to have good statistics on various aspects of social policy [than it is economic statistics]’...This interest in supplementing economic statistics with social statistics to gain a fuller picture of the quality of life has not diminished with time. There have been a number of recent international initiatives to measure the quality of life in a better way and the Office for National Statistics (ONS) is looking again at how best to measure the quality of life and well-being of UK citizens. 303

In November 2010, the UK Prime Minister David Cameron announced that the UK would start measuring the ‘progress’ of the country, not just in terms of economic growth, but also in terms of how peoples’ lives were improving through standard of living and also quality of life. 304 He stated that the Office for National Statistics (ONS) would soon start measuring subjective well-being and work towards constructing a national well-being index. The index would be devised based on extensive public and expert consultation. He also announced that the ONS would start using subjective well-being measures in its national survey and hold a national debate on what constitutes well-being so as to arrive to a new measure of national progress.

As the opening quote illustrates, however, Cameron’s announcement did not happen in a historic vacuum but can be seen as the continuation of a project of thinking about and measuring a nation’s well-being, which can be traced back to

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303 Stephen Hicks, *New approaches to the measurement of Quality of Life* (UK: Office for National Statistics 2011) 1.
at least the 1960s. The emergence of the social indicators movement, to which the quote refers, was indeed a reaction to the so-called preference satisfaction approach of the post-war period which, associated with the neo-classical economics, predicated that more income would allow individuals to satisfy more of their preferences, thus resulting in increased well-being. This understanding of well-being, together with the fact that GDP started to be measured on a consistent basis across countries after the Second World War, led to its widespread adoption and use of it as a proxy measure for quality of life. Social indicators research pointed to the inadequacy of exclusively relying on economic data and particularly on GDP as a measure of ‘progress’, that is, as a measure of how a society is doing.\textsuperscript{305} The reliance on a new set of indicators such as health, education, and infant mortality introduced the so-called objective list approach to well-being, which focuses on monitoring the basic needs and rights of the citizens which are essential to enable them to build their capabilities and flourish as individuals. The formulation of the Human Development Index for instance can be seen in this context.

The third approach, which Cameron’s announcement signals, points to the formal inclusion in national statistics of subjective alongside objective indicators, in an attempt to ‘provide wider measures of the nation’s progress’.\textsuperscript{306} To be sure, subjective well-being and happiness research is not new either. Richard Easterlin’s paper, which argued that an increase in economic growth for a country (as well as for individuals) does not translate into a rise in average levels of happiness, is considered to be responsible for the steady generation of new WBH research in economics from the 1990s onwards.\textsuperscript{307} Policy makers’ interest in subjective wellbeing

\textsuperscript{304} David Cameron, “PM speech on wellbeing” (Cabinet Office and Prime Minister’s Office, 10 Downing Street) <https://www.gov.uk/government/speeches/pm-speech-on-wellbeing> accessed 11 March 2014.

\textsuperscript{305} GDP measures the size of the market economy, which says very little about quality of life. For instance, it does not take into account of the goods and services produced by the household or by communities; it does not say anything about income distribution; and instead counts as ‘productive’ events such as forest fires, landslides, coal mining, war, prisons, and sickness because money is spent on weapons.

\textsuperscript{306} Stephen Hicks, \textit{New approaches to the measurement of Quality of Life} (UK: Office for National Statistics 2011) 2.

had been already voiced under the New Labour Government. Drawing from the work of behavioural economics and social psychology, it was suggested that there was a case for state intervention in order to boost life satisfaction. As a result, New Labour Government established an Increasing Access to Psychological Therapies programme, which made Cognitive Behavioural Therapy widely available through the National Health Service. The UK Local Government Act 2000, which gave local authorities in England and Wales the power to ‘promote the economic, social and environmental well-being’, is another example of policy-making informed by WBH research. Though conscious that the claims about the newness of WBH research and policy-making are problematic, we see 2007 as a defining moment in the international furtherance of the WBH agenda.

Certainly for the UK, but also for the UN, this defining moment comes with the launch by French president Nicolas Sarkozy of the Commission on the Measurement of Economic Performance and Social Progress led by Nobel prize winners Joseph Stiglitz, Amartya Sen, and Jean-Paul Fitoussi (Stiglitz et al. 2010).

The starting point of the report is the increasing concern about both ‘the adequacy of current measures of economic performance...[and] the relevance of these figures as measures of societal well-being’.

Acknowledging the limitations of current measures is important as ‘We are now living one of the worst financial, economic and social crises in post-war history’. The reforms recommended by the Commission would be important even in the absence of a crisis, but as the report goes on to argue, ‘some members of the Commission believe that the crisis provides heightened urgency to these reforms’. Therefore, the recommendation is to shift emphasis from measuring economic production to measuring people’s well-being.

The Commission makes clear that ‘changing emphasis does not mean dismissing GDP and production measures’. However, it points out that ‘emphasizing well-being is important because there appears to be an increasing gap between the information contained in aggregate GDP data and what counts for common people’s well-being’.

The report does two things: it acknowledges there are limits to what GDP can say about a nation’s quality of life, as it is supposed to measure only the size of the market economy, and argues that well-being is something which matters to the people and that which nations should be measuring, alongside the GDP. Indeed, the report explicitly recommends that subjective measures of the quality of life be collected by governments, a recommendation which has been quickly taken up by statistics offices around Europe as setting the agenda to which they need to respond. This argument has therefore provided the impetus for much of the work...

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313 Ibid 4.
that has been carried out since 2010 across and beyond Europe. The call for measuring subjective well-being has also been taken up by the UN in 2011, with the resolution by the General Assembly inviting member states, ‘to pursue the elaboration of additional measures that better capture the importance of the pursuit of happiness and well-being in development with a view to guiding their public policies’.

Hence, Cameron’s announcement and the work the ONS has undertaken so far can be seen as part of this agenda. The questions we are interested in exploring in the attempt to look at commonalities and discontinuities across the three sites are: first, how well-being and happiness are being conceptualised under the UK agenda; second, how such an understanding is impacting on policy making and third, the extent to which it is engendering desirable socio-economic change. The latter being the claim made by both the Stiglitz commission and the World Happiness report. Thus, following Cameron’s invitation to carry out “a re-appraisal of what matters” to people that would, ‘lead to government policy that is more focused not just on the bottom line, but on all those things that make life worthwhile’, the ONS launched a national debate on ‘what matters to you?’ between 26 November 2010 to 15 April 2011. The report summarising the findings starts with the acknowledgement that

The term ‘well-being’ is often taken to mean ‘happiness’. Happiness is one aspect of the well-being of individuals and can be measured by asking them

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318 Ibid 8.
321 According to the ONS, “[it] held 175 events, involving around 7,250 people. In total the debate generated 34,000 responses, some of which were from organisations and groups representing thousands more”. The most common answers were from a pre-defined list (health; good connections with friends and family; job satisfaction and economic security; present and future conditions of the environment; education and training). The ONS also scrutinised free text responses which emphasised “the importance of our health to our well-being; the importance of having adequate income or wealth to cover basic needs; the environment around us, and the need to connect with other people – whether partners, children, wider family, the community (local, national, faith and online, or work colleagues” . Jil Matheson, Measuring what matters: National statistician’s reflections on the national debate on measuring national well-being (UK: Office for National Statistics 2011) 5-6.
about their feelings – subjective well-being. As we define it, well-being includes both subjective and objective measures. It includes feelings of happiness and other aspects of subjective well-being, such as feeling that one’s activities are worthwhile, or being satisfied with family relationships. It also includes aspects of well-being which can be measured by more objective approaches, such as life expectancy and educational achievements. These issues can also be looked at for population groups – within a local area, or region, or the UK as a whole.322

Recognising that well-being is a complex, multidimensional concept whose meaning cannot be easily encapsulated in one single definition,323 the report then goes on to point out that the areas which emerged from the national debate as those which matter the most to people are health, relationships, work and the environment, with education and training having been added by people when asked which of the things that mattered to them should be reflected in measures of national well-being. These have since been identified by the ONS as the ‘domains’ that will need to be established as part of the national well-being framework to, ‘help capture the individual measures which together determine national well-being’, and which will eventually be expressed through a national Well Being Index. According to the ONS, this framework should be able to reflect the important finding of the national debate that individual well-being is central to the understanding of national well-being. This includes, ‘objective circumstances, for example an individual’s employment status; and subjective well-being, which includes the individual’s experiences and feelings’.324 The framework, the report continues, should also reflect the fact, ‘that national well-being is affected by how these circumstances, experiences and feelings are distributed across society, and how well current levels of well-being can be sustained into the future or between generations...’.325

There are a number of issues regarding the report, principally those concerning

measuring and quantifying, to which we will return at the end of the article. However there are two aspects that are of interest to us in thinking about the potential of the UK WBH agenda: first, the attempt to conceive of the economic and non-economic spheres of life as equally important for, indeed constitutive of, well-being. The second interrelated point concerns the recognition that well-being and happiness cannot be defined *ex ante* but should be considered instead as a process of making sense, and acting upon, what matters to people. Now, thinking about a nation’s well-being in terms of the interaction between economic and non-economic factors is an issue that goes back to at least the classical political economy of the 18th and 19th century, although the links between WBH research and Aristotle’s concept of eudemonics have not gone unnoticed. 326

Hirschman, for instance, has detailed the process through which, after Adam Smith, the passions and interests which formed a crucial part of previous social enquiry were reduced to one, the maximisation of material wealth, which would have allowed for the satisfaction of all others327 There is a similarity here between what Hirschman calls the ‘splendid generalisation’ with which Smith accomplishes this move and the preference based approach to well-being of neo-classical economics. But there are also profound differences between the two approaches. Scholars have pointed to the tensions emerging from the complex relationship between the *Theory of Moral Sentiments* and the *Wealth of Nations*: for instance, Smith’s notion of ‘sympathy’ (i.e. the ability to place ourselves in the situation of other people), which he considered the source of all sentiments informing human activity, cannot be easily reconciled with accounts about the primacy of self-interest. The problem, as Hirschman has noticed, is that scholarly and policy debate, after Smith, has reduced this complex thinking to the proposition that ‘The general (material) welfare is best served by letting each member of society

328 Ibid 112.
pursue his own (material) self-interest’. Thus neo-classical economics was purged of subjective well-being accounts, and GDP eventually became the measure of a nation’s well-being.

We therefore believe the ONS report by the National Statistician is to be welcomed for having started the process of rethinking the economy-society nexus, and for having done so with the question of what matters to people. One important issue is whether and to what extent this will reflect in changes to policy-making. Let us remember that one promise of the WBH discourse, a point made by both the World Happiness Report and the Stiglitz Commission, is the potential to effect desirable change. It is too early to assess the UK WBH agenda. However, having emphasised the potential of the work undertaken by the ONS, we also want to point to some serious concerns we have regarding the relationship between the WBH and the austerity agenda. As the ONS has pointed out, their objective is to develop well-being data and measures that can be used as tools by policy-makers, and the Cabinet Office in particular, in the design and evaluation of policy. In July 2011, the Green Book, which provides formal guidance from the Treasury of the United Kingdom to other UK government agencies on how to appraise and evaluate policy proposals, was updated to reflect the results of a review of valuation techniques for social cost-benefit analysis jointly commissioned by the Treasury and the Department for Work and Pensions. The review specifically focused on the contribution that can be played by measures of subjective well-being. The Green book makes clear that:

At the moment, subjective well-being measurement remains an evolving methodology and existing valuations are not sufficiently accepted as robust enough for direct use in Social Cost Benefit Analysis. The technique is under development, however, and may soon be developed to the point where it can provide a reliable and accepted complement to the market based approaches outlined above. In the meantime, the technique will be important in ensuring that the full range of impacts of proposed policies are considered, and may


provide added information about the relative value of non-market goods compared with each other, if not yet with market goods. A second approach, where a direct assessment of the value of a benefit or cost is particularly uncertain, is to make reference to the costs of preventing the loss of, or replacing, a non-marketed good (such as a natural habitat or recreational facility). This does not provide a measure of its value but can provide a figure to focus discussion upon whether the good is worth as much as this expenditure.\(^{331}\) (emphasis added).

What is of concern to us is not just the fact that it is only eventually, once well-being measurement has been accepted as ‘robust’ enough, that it can ‘complement’ market based approaches to valuation. The very idea that these measures will complement (or supplement, as in the ONS opening quote) rather than challenge market based approaches is problematic. As the New Economics Foundation (NEF) has pointed out, governments have always had a wide set of objectives. However, they argue, ‘much of current policy debates are biased towards one indicator, GDP growth’. The BIS website, for example, currently states that ‘every part of government is focused on growth’ \(^{332}\). And indeed, since the well-being agenda was launched in 2010, we have witnessed growth and the imperative of deficit reduction figuring prominently in austerity led policy making.\(^{333}\)

As Cameron’s words below illustrate, it could even be argued that the Coalition government’s well-being agenda can be employed to think in a very specific way about the country’s ‘progress’ in times of austerity, circumventing the very need to look at the circulation and distribution of public monies altogether:

\[T\]here’s one question in politics at the moment above all others, and it’s this one: how do we make things better without spending more money? Because there isn’t going to be a lot of money to improve public services, or to improve government, or to improve so many of the things that politicians talk about. So what follows from that is that if you think it’s all about

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\(^{333}\) See Gender Impact Assessment of the 2010 Spending Review (London, Women’s Budget Group)
money—you can only measure success in public services, in health care and education and policing by spending more money...But if you think a whole lot of other things matter that lead up to well being—things like your family relationships, friendship, community, values...That if we combine the right political philosophy, the right political thinking, with the incredible information revolution that has taken place, and that all of you know so much more about than I do, I think there’s an incredible opportunity to actually remake politics, remake government, remake public services, and achieve...a big increase in our well-being. 334

This ‘remaking’ of public services and increase in people's well-being is imagined through an expected change of people’s behaviour and attitudes. 335 Increased responsibilisation of, and reliance on, individuals to improve overall well-being in the UK is presented as leading to progress at the same time as the Coalition government is implementing a wide programme of public spending cuts. Thus, as far as the UK ‘development’ model is concerned, the potential for desirable transformation which the WBH agenda promises does not seem to have materialised. Instead, we see the separation between the productive and reproductive sphere as having been strengthened, with the latter having been further squeezed for the benefit of the former.

We turn now to the Bhutanese context to see how the WBH agenda has been conceptualised and operationalised through the Gross National Happiness prism.


According to Cameron, the wellbeing agenda will be achieved by changing the way people act. Referring to the energy saving issue, for instance, he explained: “We want to get people to be more energy efficient. Why? It cuts fuel poverty, it cuts their bills, and it cuts carbon emissions at the same time. How do you do it? Well, we’ve had government information campaigns over the years when they tell you to switch off the lights when you leave the home...The best way to get someone to cut their electricity bill is to show them their own spending, to show them what their neighbours are spending, and then show what an energy conscious neighbour is spending. That sort of behavioural economics can transform people’s behaviour in a way that all the bullying and all the informational and all the badgering from a government cannot possibly achieve.”
III. GROSS NATIONAL HAPPINESS AS A NEW DEVELOPMENT PARADIGM: BHUTAN

Much of the UN/OECD/EU WBH agenda of the last two decades can be attributed to Bhutan’s internationalising of its GNH policy stemming from a widespread perception of Bhutan as a ‘real life Shangri-La’, and as one of the world’s happiest countries (One World Education). The foregrounding of ‘happiness’ in Bhutan is not recent however; it was declared in 1675 to be ‘A Buddhist equivalent of a ‘Social Contract’” and the 1729 legal code states: ‘The purpose of governance is happiness of man and sentient beings’. Indeed, it declares that ‘If the government cannot create happiness (dekidk) for its people there is no purpose for the government to exist’. This sentiment continued to prevail with the monarch rulers established in Bhutan in 1907. The third king, for example, stated the importance of happiness alongside prosperity, as a governing objective, during his speech for Bhutan’s admission to the UN in 1971. The more recent and internationally well-known articulation of GNH was made by the fourth King Jigme Singye Wangchuck in 1979 when he stated that Bhutan was more interested in Gross National Happiness than in Gross National Product. This statement emphasising gross national happiness - as opposed to happiness alongside prosperity - was meant to be an expression of the Bhutanese unease with ‘the means and objectives’ of the dominant growth-based economic development model; particularly, as the country sought to transition from its previous concerted policy of isolation up until the 1960s to one of modernisation (with limits).

GNH was then developed and formulated into a government policy (five-year plans) from 1982 and over the next few decades, until it became enshrined in the new constitution that accompanied the shift from absolute monarchy to constitutional

336 Annie Kelly, “Gross national happiness in Bhutan: the big idea from a tiny state that could change the world” The Observer, (1 December 2012).
337 Lham Dorji, Bhutan’s pursuit of creating balanced GNH Accounts (Bangkok: National Statistics Bureau of Bhutan, 2011); Karma Ura and others, An Extensive Analysis of GNH Index (Thimphu: Centre for Bhutan Studies, 2012) 6.
340 Ibid 2.
monarchy and democracy in 2008 (with the current fifth king taking over after his father’s abdication).\textsuperscript{341} From that moment GNH became operationalized within Bhutanese governing policy as:

A holistic and sustainable approach to development which balances between material and non-material values with the conviction that humans want to search for happiness. The objective of GNH is to achieve a balanced development in all facets of life which is essential to our happiness.\textsuperscript{342}

GNH does not in and of itself equate to happiness but rather operates as a policy that underscores sustainability as part of achieving happiness, understood as a common ‘public good’ that is viewed not only through the ‘lens of economics but also from spiritual, social, cultural and ecological perspectives’.\textsuperscript{343} The first Prime Minister elected under the new Constitution of Bhutan Lyonchhen Jigmi Y. Thinley differentiates this kind of wide reaching and ‘complex’ multi-layered happiness underpinning GNH from “the fleeting, pleasurable, ‘feel good’ moods’ associated with the term particularly elsewhere.\textsuperscript{344} As the authors of ‘Happiness: Towards a New Development Paradigm – Report of the Kingdom of Bhutan’ (NDP) put it:

Bhutan’s path is founded on a clear understanding and acceptance of a higher and reasoned purpose for development that goes beyond the short-term economics and material well being of human beings and that takes into account the interdependent nature of life on Earth. It is guided by the belief that development or societal progress must achieve physical, mental,

\textsuperscript{341} Article 9(2) of the Constitution of the Kingdom of Bhutan states, “the State shall strive to promote those conditions that will enable the successful pursuit of Gross National Happiness”.


\textsuperscript{343} Karma Ura and others, An Extensive Analysis of GNH Index, (Thimphu: Centre for Bhutan Studies, 2012) 7.

\textsuperscript{344} Karma Ura and others, An Extensive Analysis of GNH Index (Thimphu: Centre for Bhutan Studies, 2012) 8, quoting Lyonchhen Jigmi Y Thinley, Educating for Gross National Happiness (Thimphu 2009).

emotional and spiritual well-being as a condition for the fulfilment of human potential and for genuine happiness in harmony with nature.\textsuperscript{345}

Although there are of course similarities in how happiness has become operationalised through well-being policies and measures for the purpose of government policy making in both Bhutan (see below) and the UK, it is important to note the differences. As Priesner argues, in Bhutan the political impetus for happiness policy making has come from its specific Buddhist culture and spiritual beliefs and customary practices.\textsuperscript{346} Thus, as we see in NDP Report,\textsuperscript{347} the Bhutanese conceptualisations of happiness orientate\textsuperscript{348} development towards a different interaction of objectives by emphasising the inter-dependence of spheres of life that go beyond the material concepts and also focus, for example, on the spiritual concepts. Although current GNH policy making is not explicitly linked to Buddhism, it is clear that the normative values stemming from Buddhist beliefs give rise to the idea of a ‘higher and reasoned purpose’ that places importance on spiritual well-being, environmental protection as well as on economics and, indeed, highlights their interdependence in achieving happiness; particularly, in achieving a form of happiness that is not ‘fleeting’ as former Prime Minister Thinley puts it. The importance of the inter-dependence of these factors is shown in the diagram below from the NDP report,\textsuperscript{349} where spheres of life are not perceived as parallel, existing neatly side by side, but rather are viewed as co-produced, intertwined and even fractual, seeping into one another.

\textsuperscript{345} Gross National Happiness Centre (n.d.), “What is Gross National Happiness?” Gross National Happiness Centre <http://www.gnhbhutan.org/about> accessed 16 March 2014 (emphasis added).

\textsuperscript{346} Stefan Priesner, \textit{Gross National Happiness – Bhutan’s Vision of Development and its Challenges} (United Nations Development Programme: UN 1999). A detailed analysis of the ways in which happiness might be understood in Bhutan is beyond the scope of this article. However, see Third Person (forthcoming) for more discussion in relation to specific ‘GNH in action’ case studies.

\textsuperscript{347} NDP Steering Committee and Secretariat (2013) \textit{Happiness: Towards a New Development Paradigm}. Royal Government of Bhutan.

\textsuperscript{348} Here we draw on the work of Sarah Ahmed’s ‘The Promise of Happiness’ where she discusses how happiness can also be understood as a process that ‘orientates’ us towards certain ‘objects’. Sara Ahmed, \textit{The Promise of Happiness} (Durham and London: Duke University Press 2010).

\textsuperscript{349} NDP Steering Committee and Secretariat (2013) \textit{Happiness: Towards a New Development Paradigm}. Royal Government of Bhutan.
This conceptualisation of the economy-society nexus is therefore very different from that articulated through the UK WBH agenda. Assessing what GHN has meant in practice so far, which is what we do next, will enable us to better delineate the differences between the two contexts. The GNH ‘philosophy’ developed within Bhutan in the 1970s has been operationalized since 2008 into a ‘multidimensional’ concept including ‘core objectives’ in four key strategic areas known as ‘pillars’. These are 1) fair socio-economic development (better education and health), 2) conservation and promotion of a vibrant culture, 3) environmental protection and 4) good governance. These four pillars have been further subdivided into nine ‘domains’ or dimensions, which were selected on normative grounds that have also become the basis of a GNH index (discussed below). The nine domains include psychological well-being, time use, community vitality, cultural diversity and resilience alongside ecological diversity and good governance; with the latter two being taken up by other countries more recently. The domains also include other standard strategic government areas such as health, education, and living standards with the Bhutanese government providing free education and health to all its citizens.350

From the mid-2000s the Centre for Bhutanese Studies (CBS),351 have been constructing and revising a GNH index which is supposed to act as a ‘more
profound’ way ‘to capture human wellbeing’ than traditional socio-economic measures of economic, human or social development. The 2010 Index includes a further set of 33 indicators and 124 sub indicators or variables under each domain.\textsuperscript{552} A full analysis of the Index is beyond the scope of this article. However, it is important to emphasise that both the indicators and the Index are not conceived of as measuring happiness ‘as it really is’. As mentioned above the domains and indicators were the result of a normative process conducted within the CBS during which the parameters for thinking of, and measuring, happiness were elaborated. Once these parameters have been set and indicators subsequently formulated, the GNH Index can be used to analyse the journey of Bhutanese people towards achieving GNH through surveys that are carried out every three years.\textsuperscript{553} This is why as Dr. Saamdu Chetri, the executive director of the GNH Centre, put it to us, that GNH is better conceived of as a tool of policy-making which creates the conditions for happiness, bearing in mind these conditions are the outcome of a political process. We will address the implications this has for thinking about the relationship between WBH measurement and the reality it is supposed to describe, in conclusion.

For the time being it is interesting to note that, given the fact that well-being measurement can be deployed in very problematic ways, as discussed above in relation to the UK context, the CBS report does raise caution about an index being ‘limited and insufficient’.\textsuperscript{554} However, it also asserts that GNH, ‘measures the quality of a country in a more holistic way than GNP’; that it can do what, ‘no other single tool can do’ namely: ‘sketch roughly how GNH is evolving across Bhutan as a whole over time, as well as for different groups, regions and people. It can also convey how people are happier – or unhappier – than previously, and thus informal practical action.’\textsuperscript{555}

There is clearly a need to account for the implementation of GNH policy. Whilst undoubtedly part of this is practical in terms of, for example, making decisions about resource allocation, there is also a wider implicit agenda at play whose objective is to engender a shift in the way we value different aspects of life. This is evident in the words of Dr. Chetri who, asked by us about the limitations of quantifying incommensurable realms of life, is adamant to point out that ‘if we shift what we measure, there can be a system shift’.\textsuperscript{556} ‘This is a sentiment shared by Dr. Tho, Programme Director of the GNH Centre, for whom ‘what we measure
is what we become aware of’. Whilst they both acknowledge that attributing economic value to every aspect of life is not desirable, they see measurement as a way to bring consciousness to areas that have not mattered, whether that be the environment, unrecognised labour, etc., although this process needs to be accompanied with a simultaneous problematizing of the language being used, such as ‘capital’ or indeed economic value. Clearly, there is an audience beyond Bhutan’s borders, indeed a co-constituent part of the measuring being undertaken in Bhutan’s GNH policy and the model it is presenting to the international community, evident most clearly in the NDP report.

However, it is worth noting that whether as part of an instrumental approach for planning and resource allocation (with the Index orienting policy making towards...
areas in need of intervention) or indeed as part of awareness shifting to areas of life that have gone undervalued, the impulse to measure is being taken even further. In 2010, Bhutan initiated a movement from a conventional GDP-based accounting system and economic paradigm to a holistic model, accounting for environmental, social and cultural values in accordance with GNH principles. In a report entitled ‘Valuing Bhutan’s True Wealth’, there is an outline of how a new set of National Accounts for Bhutan might potentially look like. The report shows how Bhutan’s wealth could be practically measured, including not only traditional material capital but also natural, social, cultural, and human capital. To do so, ecological economists developed full-cost accounting methods, and developed valuations and methodologies, including those assessing non-market values that can be translated into the Bhutanese context. A number of these experts have also volunteered to work with Bhutan in the next few years to help develop and integrate these measures into the new National Accounts, and they have already developed preliminary estimates of the economic value of Bhutan’s ecosystem services and voluntary work as key examples of natural and social capital. They suggest measuring not only progress (i.e. how policy-makers address changes in happiness over time) but also the economic value of different forms of capital against which they can assess more accurately the costs and benefits of newly proposed economic activities. They claim that both forms of measurement are essential in policy formation, and it is this dual approach that distinguishes Bhutan’s GNH Index and new National Accounts from other measurement systems that rely on indicators alone. It is also suggested that this approach could be adopted in other countries’ official national accounts.

With both the Index and the new accounting system acting as a model for other countries joining the WBH agenda, we also want to explore whether there might be other reasons that have led to what is now almost a contemporary international industry serving the production of nationalised forms of happiness. As Priesner argues, it is important to understand the geo-political conditions which have

361 Ibid.
given rise to the institutionalisation and shift from ‘happiness’ as articulated in the leader Zhabdrung’s 1729 legal code - namely, as a governing objective in Bhutan to the proliferation of happiness as an integral part of an international post-2015 development agenda. His analysis foregrounds the importance of a historicised view that takes into account the political conditions in which Bhutan was forced to move away from a policy of isolation to one of ‘development’ and modernisation in 1959, primarily because of the Chinese invasion of Tibet on its northern border. In a visit in 1958, Nehru had expressed India’s concerns for Bhutan’s security, as its neighbour to the north, and offered assistance, for example to build a road link between the two countries.\(^{363}\) However, at the time this was refused and put on hold until the Tibetan revolt was put down and China began activities that led to the closing off of an important trade route between Tibet, Sikkim, Bhutan and India. Bhutan then prioritised security and accepted building links with India. Once the security threat became less urgent Bhutan had already abandoned isolationism and was on the ‘development’ path, which according to Priesner, was in a way far less gradual than might have otherwise been the case had it not been so abruptly forced to respond to the security issues. Thus, whilst Bhutan cannot be said to have been a colonised country as such, its development trajectory has certainly been influenced by colonising forces at play around it. Indeed, the former Minister of Education, Thakur S Powdyel, a key architect of GNH education within Bhutan, referred to the pressure of these ‘forces’ upon Bhutan as a ‘blizzard’ and to GNH policy-making as part of an ‘anti-blizzard’ response to development and modernisation.\(^ {364}\) It is interesting and understandable then that, once re-focusing on how to develop Bhutan in a global context, GNH comes to be articulated in the 1980s by the fourth King in opposition to GDP.

In 1998 this pronouncement, having been developed into the GNH philosophy for Bhutan, was first presented to the international community as a different approach to development. Thinley, Prime Minister at the time, explained the philosophy of GNH in his key-note speech to the Millennium Meeting for Asia and the Pacific in Seoul, Republic of Korea. He stated that Bhutan wanted to ‘maintain the balance between materialism and spiritualism, in the course of getting

\(^{363}\) Ibid 31.

\(^{364}\) S. Thakur Powdyel, “Inaugural address” (The GNH Centre workshop: ‘From Contemplation to Action’, 27 January 2014).
the immense benefits of science and technology’. He also articulated Bhutan’s vision of development:

‘In addition to the conventional notion of development that focuses on quantifiable indicators of economic prosperity, Bhutan’s vision of development stresses non-quantifiable goals such as spiritual well being and gross national happiness. We do this through a concerted policy of cultural promotion and the provision of free education, health and other social services’.

He expressed criticism of the mainstream economics’ concern with efficiency of production and distribution and, instead, suggested focusing on ‘ethics, ideologies, faiths and institutions, which favour sustainable lifestyles at a collective level’. In his view, the pursuit of self-interest is not only non-productive but actually counter-productive, as it threatens the rich bonding of individuals as members of extended families and communities.

Our aim is not to challenge the merits and objectives of the NDP but rather to suggest that it can be viewed as an outward movement or internationalisation of Bhutan’s philosophy and policy-making. What we find interesting is the way in which Bhutan has moved, in a relatively short space of time, from an isolationist position, fending off the ‘blizzard’ - various forms of what might be viewed as being colonized - to now being at the forefront of and leading an international WBH agenda. Bhutan’s approach has not been one that has espoused the language of anti-colonial resistance like other countries such as Ecuador (see below). Indeed their approach is quite the opposite, at least internationally, in espousing the language of global co-operation. There is nevertheless a sense of fear and threat from the outside world, both in terms of its superpower neighbours and the growth-led development model (the ‘blizzard’), that is somewhat masked by the

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conciliatory tones of co-operation and interconnectedness. This raises questions about whether we can view Bhutan’s leading the post-2015 development agenda and forging ahead with measurement and value indexes not just as the contribution of a ‘happy country’, but rather also as incorporating a deeply felt ‘anti-colonial’ stance, similar to other instances where a refutation of growth economics through well-being policy-making has been much more explicitly articulated in the language of resistance. After all, as the words of former Prime Minister Thinley indicate, when he states that: “Bhutan’s vision of development stresses non-quantifiable goals such as spiritual well being and gross national happiness” it is clear that there is a definite ambiguity or tension in the use of quantification for measuring, particularly in relation to immaterial factors that are considered as important, if not more so, than the material ones. This goes at the heart of the measurement through quantification issue which we will address in the conclusion.

In the meanwhile, it is clear then that there is a different conceptualisation and understanding of the interaction between social, economic and other spheres of life in the Bhutanese context from that of the UK. There is also therefore a difference in commitment, if not application, to the use of quantification of these factors in measuring national well-being. This is also evident in a second significant difference in the two contexts, in that Bhutan’s emphasis on structural transformation – as part of modernisation and development – is very much predicated on the idea of ‘inner’ transformation. Whilst we are not able to elaborate on the detail of this aspect of GNH here, it comes back to the importance of the immaterial, to the spiritual as Thinley states. As the NDP outlines, these inner

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371 It was the current King of Bhutan who stated: “We must value life... over acquisitiveness and profit. We must also recognise the difference between needs and wants, and value needs over wants” NDP Steering Committee and Secretariat (2013) Happiness: Towards a New Development Paradigm. Royal Government of Bhutan.
values are linked to the ideas of giving, service to others and thinking of ‘needs rather than wants’. This language is obviously referring to the need for self-sufficiency, clearly an important policy imperative, and therefore intended as a way to stem the desire for material goods that comes with globalising influences upon Bhutan. However, it is also simultaneously seeking to catalyse a shift in consciousness amongst the rest of the world towards thinking more deeply about an alternative development model. We now turn to another context, that of Ecuador, in which well-being has emerged and developed not only as a fundamental guiding principle of policy making but also as a challenge to the global development agenda.

IV. **Buen Vivir and the challenge to development: Ecuador**

The emergence of well-being policies in Ecuador has to be seen in the context of the broader political, socio-economic and cultural transformations that have swept the Latin American region in the last two decades in response to the ‘shock therapies’ forced on the continent: not only the neo-liberal ones of most recent memory but also the colonial one which goes back to the time of conquest with the concurrent introduction of both European modernity and capitalism. Escobar for instance has seen the recently forged nexus between the social movements and the state in Ecuador, Bolivia and Venezuela, as representative of a historic conjuncture brought about by the crisis of the neo-liberal project and that of euro-modernity, of which development thinking is an integral part. Although Venezuela, Ecuador and Bolivia are not the only states in South America experimenting with alternative socio-economic, political and cultural models, they are certainly those reacting most explicitly to what they see as a failing neo-liberal project which has produced extreme inequality and violence.

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373 Ibid 11. This dual crisis has for him opened the way to two competing projects: “(a) alternative modernizations, based on an anti-neo-liberal development model, in the direction of a post-capitalist economy and an alternative form of modernity ...;[and](b) decolonial projects, based on a different set of practices (e.g. communal, indigenous, hybrid, and above all, pluriversal and intercultural), leading to a post-liberal society (an alternative to euro-modernity)” The question he pursues is which of these two kinds of project is taking shape in Ecuador, Bolivia and Venezuela.
374 Constitución de la República del Ecuador, 2008.
In Ecuador in particular, BuenVivir has emerged as a paradigm encapsulating the experimental quality of such policies with the 2008 Constitution explicitly recognising the decision ‘to build a new form of co-existence ... to achieve the good life [BuenVivir], the Sumak Kawsay’. The BuenVivir paradigm owes much to ‘the social, political, and epistemic agency of the indigenous movement’ which has responded to the shock of development policies. As Acosta has pointed out, the experience of collective life of indigenous peoples has formed ‘an essential element for thinking differently about society, a society that valorises popular knowledge and technologies, that organises itself in solidarity and devices endogenous responses’ (Acosta 2009). And the experience of the indigenous movement has come to converge with the analyses and proposals advanced by feminist and environmental economics who have for decades questioned the notion of the economy as separate from other realms of life; and with the critique of post-development scholars who have challenged the idea that ‘development’ is both necessary and desirable.

The conceptual shift from development to BuenVivir informed by the philosophy of Sumak Kawsay is explicitly articulated under the National Plan para el Buen Vivir (National Plan for Well-Being) where the government acknowledges that ‘underlying the idea of development, progress and modernisation is the conceptualisation of a linear time in which history has only one meaning and direction: developed countries are ahead, positing the model for all societies to follow’. This world-mentality has produced prominent ontological assumptions such as the separation of humans from non-humans, and of certain humans from others, and the separation of ‘the economy’ from other realms of life. This is in contrast with the ‘full life’ or vida plena to which Sumak Kawsay refers and

376 Christina Carrasco, “Mujeres y trabajo: entre la invisibilidad y la precariedad” in Mujeres y trabajo: entre la precariedad y la desigualdad, (Madrid: Consejo General del Poder Judicial 2008).
according to which ‘the world above, the world below, the world outside and this world are connected to each other and are part of a whole within a spiral, and not a linear perspective of time’, a perspective that emphasises ‘relationality and reciprocity; the continuity between the natural, the human and the supernatural...and the embeddedness of the economy in social life’, or put in other terms, the interconnectedness of the productive and reproductive spheres.

Buen Vivir has therefore been presented by the government as a project that rejects the development paradigm of the post-war period with its colonial legacy. As Madgalena Leon has argued, moving away from the ideological orbit of ‘development’ means thinking of other ways of producing and consuming as well as organising and sharing life. In this respect, the Plan aims to promote the transition from an extractivist model of colonial origins to a ‘bio-pluralist’ economy that recognises and valorises different forms of life, different forms of economy, and different property relations. This, the Plan continues, requires an active investment in the production and reproduction of life, with investments in areas ranging from food, housing, health and education, to energy, technology, environmental and bio-services as well as wide-ranging agrarian reforms.

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385 This is not only because of the difference between stated objectives and actions, particularly with respect to the disenchantment by the indigenous movement with the Correa administration with respect to the realization of the plurinational state which has come to be more about recognition of diversity rather than real decentralization of power). There are for him tensions between the post-development orientation of these programmes and the permanence of deeply rooted developmentalist conceptions such as growth and competitiveness Arturo Escobar, “Encountering Development: The Making and Unmaking of the Third World” (Princeton: Princeton University Press 1995) 23. Growth (although based on the tertiary sector rather than on the extraction of petroleum) and competitiveness (although based on cooperation rather than competition) are concepts that run alongside the recognition that all living beings (humans and non humans) are above capital. Thus oil extraction continues to take place in order to pay for the policies of re-distribution. Indeed when we visited Ecuador the then finance minister Elsa Viteri, stressed the need to still rely on the extractivist sector, although in a more sustainable way, so to accomplish these objectives and facilitate the transition towards an economy less reliant on petroleum.
The extent to which the Plan and subsequent government action have managed to inaugurate a post-development and de-colonial era, remains an open question. Escobar’s view is very cautious while pointing towards the continuities and discontinuities with both the developmental and the colonial projects. Catherine Walsh has also argued that although Ecuador’s well-being paradigm is based on a distinct Andean philosophy, it presents many similarities to the European welfare state. A cursory look at the key principles of BuenVivir adopted by the 2008 Constitution would seem to point in this direction, with the promise of a national education system ‘designed to develop the abilities and improve potentiality among individuals and the collective society based upon knowledge of technology, the arts, and an understanding of culture’, a national health care system ‘based on the development, protection, and revitalization of the potential for a healthy, integral lifestyle for both individuals and the collective community based upon a recognition of social and cultural diversity’, and a social security system which ‘is public and universal, and not privatized’.

However, the re-conceptualisation of the society-economy nexus is important in both analytical and political terms. Although, unlike the Plan Nacional, the Constitution retains the term ‘development’, this is seen as being ‘constituted by the organized, sustainable and dynamic ensemble (conjunto) of the economic, political, socio-cultural and environmental systems, coming together to ensure the realization of the good life, Sumak Kawsay’. As Leon notes the relocation of the economic system as one component of this ensemble traversed by a commitment to BuenVivir entails the widening of the objective of the economy, this is no longer attached to a normative ideal of accumulation but is defined as social and solidarity (Art 283). As with the NDP put forward by the Bhutanese government, this widening entails not only rejecting the idea of the economic axis as running parallel to the societal and the environmental axes, as neo-classical economics would have it. It would also mean doing away with the axes altogether.

387 Art 343
388 Art 358
389 Art 367
390 Art 283
and recognising the co-production of these different spheres, something we have seen what Bhutan’s NDP also does.

According to Leon this analytical focus has already engendered outstanding political innovations: the concepts of food and economic sovereignty and the subsequent agrarian reforms; the reconceptualization of work and recognition in all of its forms, including care work and the extension of social security to all labourers, the acknowledgement of the diversity of forms of production.

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392 Access to land is recognised on basis other than through private property (Art 57). This has provided the legal basis for the new agrarian reforms. The National Assembly adopted, in February 2009, the Food Sovereignty Law, which mandates the immediate development of: a policy of redistribution of land and means of production; Preferential financing mechanisms for small and medium producers; measures for the preservation and recovery of agrobiodiversity and ancestral knowledge; and the preservation and free exchange of seeds. Magdalena Leon, “El ‘buen vivir’: objetivo y camino para otro modelo,” in I. Leon (ed), Sumak Kawsay / Buen Vivir y cambios civilizatorios (Quito: FEDA EPS 2010) 148.

393 Right to Work: Unlike the 1998 Constitution which stated that “Work is a both a right and a social duty”, the new constitution provides that: “All modalities of work are recognised, whether working as employees or independent, including the work of self sustenance and human care, and as productive social actors to all workers” (art 325). According to Leon, recognizing all forms of work and their productive nature (with particular emphasis on care work) and extending protection and social security does historical justice to people and communities that had been stripped of their economic status and correlative rights. Magdalena Leon, “El ‘buen vivir’: objetivo y camino para otro modelo,” in I. Leon (ed), Sumak Kawsay / Buen Vivir y cambios civilizatorios (Quito: FEDA EPS 2010). 117

294 Right to Work: Unlike the 1998 Constitution which stated that “Work is a both a right and a social duty”, the new constitution provides that: “All modalities of work are recognised, whether working as employees or independent, including the work of self sustenance and human care, and as productive social actors to all workers” (art 325). According to Leon, recognizing all forms of work and their productive nature (with particular emphasis on care work) and extending protection and social security does historical justice to people and communities that had been stripped of their economic status and correlative rights. Magdalena Leon, “El ‘buen vivir’: objetivo y camino para otro modelo,” in I. Leon (ed), Sumak Kawsay / Buen Vivir y cambios civilizatorios (Quito: FEDA EPS 2010). 117

295 Right to Economic Activities: Unlike the 1998 Constitution which enshrined the ‘freedom of the enterprise’ (Art 25), the new constitution refers to the right to engage in economic activities, individually or collectively, according to the principles of solidarity and social and environmental responsibility” (Art 66). Economic activity is here understood as including all the ways of doing economy, not just those who have the capital base and purpose (ie companies). This is complemented by the substitution of the term ‘company’, running through the text of 1998 Constitution, with the more general and inclusive ‘economic unit’. Magdalena Leon, “El ‘buen vivir’: objetivo y camino para otro modelo,” in I. Leon (ed), Sumak Kawsay / Buen Vivir y cambios civilizatorios (Quito: FEDA EPS 2010) 116. This means that protection and financing by the state extends to all activities.
economic exchanges and property, the latter in its associative, community, cooperative, and popular dimensions in addition to its private forms and all receiving support from the state,\textsuperscript{396} are among the most important innovations.

Similar to what has happened in Bhutan with the NDP, Ecuador’s adoption of \textit{BuenVivir} has comported a conceptual shift consisting of both the rejection of the normative assumptions of the post-war development enterprise, including the idea that the economy can be isolated from other domains of life, and the embracing of alternative principles, such as those of complementarity and relationism derived from \textit{Sumak Kawsay}, to guide policy making. As Leon puts it, the reconceptualization of the economy as an integral part of life requires ‘... changes in the productive matrix, in the visions and policies about who and what constitutes the economy, what and how to produce, what and how to eat, and ultimately of how to reproduce life’.\textsuperscript{397} As already mentioned, whether such changes point in the direction of a post-development and post-colonial project is an open question. What is clear, however, is that the convergence of the indigenous, environmental, left and women’s movements since 2007 has brought about various attempts, including in the policy making arena, to experiment with alternative visions of living together, actually existing or not.

Therefore, this focus on well-being is very different from that adopted by the UK, not only because of the critique \textit{BuenVivir} brings to neo-liberalism and development, which is absent in the UK, but also in terms of its potential for

\textsuperscript{396} Unlike the 1998 Constitution which supported various forms of property (art 30-34) but did not name them, the new text acknowledges: “The right to property in all its forms, with social and environmental roles and responsibilities (Art 66, 26). Private property is recognised alongside public, communal, state and associative. The Constitutions recognises the inalienable, imprescriptible and indefeasible character of non renewable natural resources, which is state property, as well as the property of indigenous peoples to their territories. It also speaks of the need to democratize access to the factors of production, through the promotion of equitable access policies that “avoid concentration or hoarding... promote redistribution and delete privileges or inequalities...” (Art 334,1). The same focus on redistribution is to be found in relation to food sovereignty, which is assigned the responsibility of the State to “promote redistributive policies allowing access of peasants to land, water and other productive resources” (art 281,4). This has provided the basis for the agrarian reformsMagdalena Leon, “El ‘buen vivir’: objetivo y camino para otro modelo,” in I. Leon (ed), \textit{Sumak Kawsay / Buen Vivir y cambios civilizatorios} (Quito: FEDAEPS 2010) 118.

transformation. As the Plan adds, what today is presented as ‘the horizon of post-
eo liberalism might become in a few years a more integrated proposal for a
better life for all people... therefore pointing to the possibility of something else
in the future’. It is the potential for this ‘something else’ we see missing in the
case of the UK where not only growth continues to have the last word on policy-
making decisions, despite the proliferation of WBH initiatives, but also cuts to
social spending and the heightened pressure on individuals to provide safety nets
for themselves and their ‘communities’ in the face of a receding welfare state point
in the direction of a further separation between the productive and reproductive
spheres.

We have discussed the difference in the way in which well-being is understood
and actualized in both Ecuador and Bhutan compared with the UK. Being aware
of its own ambition to foster internationally an NDP, Bhutan has adopted a less
explicit condemnation of the normative assumptions underlying the international
development agenda. The reconceptualisation of the economy-society nexus as
envisioned in the NDP, however, is no less challenging than the Ecuadorian one, as
it also brings to the fore the interconnectedness between the productive and re-
productive spheres of life. Thus, the first conclusion we draw is that despite sharing
a critique of GDP as a measure of national well-being, these are three different
contexts where well-being is understood and actualized in very distinct ways.
Thus, we argue that emphasizing the transnational dimension of the WBH agenda
without paying attention to its very different manifestations is not only analytically
inaccurate, it also dilutes its potential for socio-economic transformation.

There is however a second interrelated conclusion we would like to tentatively
make as a way to open up questions for future research. It concerns the WBH’s
focus on quantification and measurement. Although Rene’ Ramirez, the Secretary
of the Ecuadorian Commission on Planning and Development, announced in
2010 that Ecuador would soon start to measure individual happiness levels, this
has up to now meant utilising the data provided by the office for national statistics
(Instituto Nacional de Estadisticay Censos) to look at life satisfaction levels across
regions in terms of employment, health, education, time use, social relations,

Estado Plurinacional e Intercultural. Quito: SENPLADES.
political participation, governance, and the environment. So Ecuador has so far employed the widely used social indicators or objective list approach we have referred to earlier. In a subsequent article Ramirez recognises that measuring ‘relational goods’ is neither entirely feasible nor desirable, echoing the concern also expressed by Thinley; yet, he sees measurement as a necessary tool to guide policy-making.\textsuperscript{400} It remains to be seen, whether Ecuador will invest more resources in producing and utilising subjective well-being data in the future. This however appears to be a growing international trend, of which the UK and Bhutan are two clear examples, particularly after the UN’s call for member states ‘to pursue the elaboration of additional measures that better capture the importance of the pursuit of happiness and well-being in development with a view to guiding their public policies’.\textsuperscript{401}

While we appreciate that measuring well-being, as in the case of the GNH Index, might provide a useful compass for policy making, we want to conclude by reflecting on the relationship between WBH measurement and the reality it is supposed to describe. In noticing the disjuncture between the ONS report, its findings and the UK austerity led policy-making, we are not making an argument about the need for the government to base its policies on subjective well-being data, assuming the latter reveals incontrovertible facts about well-being and happiness. We are rather seeking to open up questions about the WBH reality that is being created through such measurement. By emphasising the difficulty about quantifying the ‘unquantifiable’ and measuring ‘relational goods’, which both Thinley and Ramirez highlight, we are neither saying that measurement is an impossible task nor that it is a new phenomenon.

Indeed, as Mary Poovey has shown in her analysis of the epistemological shifts characterising the science of wealth and society in Britain between the 15\textsuperscript{th} and the 19\textsuperscript{th} century, it took a long time, and the unfolding of a non-linear series of

\textsuperscript{399} René Ramírez, \textit{La Felicidad como Medida del Buen Vivir en Ecuador: entre la materliad y la subjectividad}. (Quito: SENPLADES 2010).

\textsuperscript{400} Indeed he suggests that the most appropriate ‘proxy variable’ for WBH is the time each one of us can devote to these relational goods. René Ramírez, \textit{La Felicidad como Medida del Buen Vivir en Ecuador: entre la materliad y la subjectividad}. (Quito: SENPLADES 2010) 248.

philosophical developments, for measurement to be linked to counting and numerical representation.\textsuperscript{402} Before moral philosophy gave the way to political economy, that is at the time when liberal governmentality took the place of absolutism and at stake was knowledge about self-governing subjects rather than coercive rule, counting was still neglected. Ethical and theological consideration were the measure so that ‘Insofar as the ‘value’ of some action could be measured, ‘measurement’ had less to do with quantification than with determining the ‘fit’ between the action and God’s laws’. And when Adam Smith followed Petty’s call for numbers to be taken into account by legislators, he deemed numbers descriptive in a particular way: instead of being accurate as in reflecting the reality they were representing, they were meant to describe the reality that could emerge once his economic theory was applied. McCulloch however was soon to introduce a taxonomy of knowledge which separated ‘the collection of data from the production of general, that is theoretical, knowledge’ by making a distinction between ‘the descriptive and theoretical functions of what Smith... had represented as a single endeavour’.\textsuperscript{403}

These different approaches to numerical representation informed the debates about the nascent science of statistics in the 1830s. Thus, the Statistical Society of London, which was established as a section of the British Association for the Advancement of Science (BAAS), made clear in its statement of purpose that statistics ‘does not discuss causes, nor reason upon probable effects; it seeks only to collect, arrange and compare, the class of facts which alone can form the basis of correct conclusion with respect to social and political government’.\textsuperscript{404} This position was fiercely attacked in 1838 by Robertson, the sub-editor of the London and Westminster Review, who argued that facts could not be distinguished from theories and that anyone who tried to make this distinction deprived statistics of any epistemological power.\textsuperscript{405} Eventually, it was the Society’s agenda which prevailed as the equation

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of statistics with the collection of numerical data was relied upon by the British government to justify its growth through the argument that statistics was necessary to avoid legislating ‘in the dark’. By 1834, Poovey concludes, when the New Poor Law was passed ‘the machinery of government of Britain was indissolubly tied to the collection of numerical information, even though the methodological problems that persisted in the statistical variant of the modern fact had yet to be solved’. 406

Today, unlike at the time of the New Poor Law, the UK government might base its policies on WBH data in order to recalibrate its ‘machinery’. However, this is only one dimension of the relationship of the UK WBH agenda. What we think needs to be investigated much more thoroughly, within and beyond the UK, concerns at a more fundamental level the claims that WBH measurement makes about the reality (well-being and happiness) to which it refers. If we take both Smith and Robertson’s arguments seriously, we might need to acknowledge that both Well-being and Happiness are abstractions (in the sense indicated by Smith) rather than entities that exist ‘out there’ prior to our investigation, which is not the same as to say they cannot be measured (they clearly can be as the GNH Index demonstrates) or that their measurement does not produce material effects (for instance in relation to the distribution of resources the Index could comport). Consequently, we will need to closely scrutinise the ‘theories’, ‘opinions’ and ‘guides’ that lead researchers to measure WBH. As Davis and others have pointed out, 407 this is not only a question of who is doing the measuring. The UK ONS, for instance, can be commended for having attempted to find out what matters to people. However, and this extends beyond the UK context, if what matters to people is co-produced by the kind of questions that are asked and the parameters that are set for the investigation, neither of which are neutral and value free (i.e. family, community vitality), then it is important to interrogate the process through which these parameters or questions are formulated and indicators such as the GNH index become powerful technologies of governance. 408 Relatedly, WBH’s

406 Ibid.
408 Kevin E. Davis and others, “Indicators as a technology of global governance” (2012) 46(1) Law and Society Review 71.
translation into the GNH index raises important methodological questions about how WBH and its promise for the inter-connectedness between the productive and re-productive spheres of life can be conceived of through different, even potentially conflicting modes of thinking. If, as Shapin and Shaffer argue,409 ‘questions of epistemology are also questions of social order’ then asking what order is being created through WBH and its measurement seems a very important question.

Indian and Chinese FDI in Developing Asia: The Standards Battle Beyond Trade

By
Leïla Choukroune*

ABSTRACT

At a turning point for trade governance, while developing Asia has become, for the first time, the world’s largest investor region, this article critically examines the normative battle at stake between China and India in their Asian International Investment Agreements (IIAs) in focusing on international investment law standards of treatment generally and the National Treatment (NT) precisely. Starting from a historical and conceptual perspective shedding some light on the different phases of the standard of treatment’s acceptance and denial, this article develops into a substantial analysis of the scope and application of the NT in Chinese and Indian Asian IIAs as a concrete and effective alternative to currently proposed solutions based on the limited and often tautological ideas of states’ autonomy to regulate and other novel ‘flexibilities’. Lastly, as a conclusion, it argues in favour of a more strategic use of the national treatment standard, and the qualifications/exceptions it assumes, to foster states’ sovereign economic paths and development strategies.

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INTRODUCTION

‘If we don’t write the rules for trade around the world, guess what: China will.’

While President Obama’s statement has the merit of reiterating American ambitions over the world’s governance and the genuine nature of the normative battle at stake between the US and China, it also proves relevant to many other nations, including China and India, at a turning point for trade governance and a crucial moment for their development as Asian and global leaders. In 2014, developing Asia has become, for the first time, the world’s largest investor region (with USD 440 billion outward FDI), hence overtaking North America (with USD 390 billion) and Europe (with USD 286 billion). China and India have played a large part in this massive expansion with Hong Kong becoming the second largest investor in the world behind the US, and FDI outflows from India increasing fivefold to USD 12 billion in 2014. This concrete realization of Narendra Modi’s ‘Act East’ and China ‘Good Neighbour’ policies herald tremendous new developments for the world. Beyond trade statistics and other investment flows, there is now another lengthier and deeper struggle; that of a political redefinition of the rules governing global economics.

With more than 3000 International Investment Agreements (IIAs) and almost 600 Free Trade Agreements (FTAs), the production of economic norms for global and regional integration has reached an unprecedented stage. As part of a response

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410 See President Obama: <https://twitter.com/barackobama/status/596721150291378176> accessed 17 August 2015 and on how to make case for the Transpacific Partnership: <https://www.youtube.com/watch?v=A16Dptv_Nus> accessed 17 August 2015 and the need to ‘raise the standards’ as a reaction to China.


412 Ibid.

413 See UNCTAD (n 3).
to the limited evolutions of multilateral trade negotiations conducted by the World Trade Organization (WTO), a myriad of mega-regional trade and investment agreements are currently being negotiated. From the Transatlantic Trade and Investment Partnership (TTIP), to the Trans-Pacific Partnership (TPP) or the Regional Comprehensive Economic Partnership (RCEP), the magnitude of these new deals is simply immense! This bewildering array of new legal instruments covers an incredibly vast legal and political landscape at the crossroads between trade, investment and essential societal concerns such as human rights, labour, health and environmental protection. From ‘regulatory cooperation’ to a more ambitious ‘regulatory convergence’, these initiatives question the very nature of regulation as an attribute (or not) of the state. The way in which the tension between the economic gains of a comprehensive integration and the societal implications of potential restrictions on regulatory autonomy is mediated will eventually determine who sets the rules and so wins the trade game.

In this regard, India and China have taken a rather heterodox path, which might appear for many as an alternative to ‘western rules’. This international law, which they hardly had a hand in creating, has not reduced their normative autonomy. On the contrary, India and China have, differently, seized on it to strengthen their powers and created – if not yet exported – a *sui generis* model mixed with norms imported and reinterpreted in light of creative practices embedded in contrasted histories and political regimes. As a matter of fact, India was one of the 23 original contracting parties of the General Agreement on Tariffs and Trade (GATT) and a founding member of the WTO, but China has only acceded to the WTO in December 2001, after more than 15 years of complex negotiations questioning the very nature of its ‘socialist market economy’. While India has played a central role in the introduction of development issues within the GATT and was one of the main negotiators of the Generalised System of Preferences (GSP) adopted in 1968 in the context of the second United Nations Conference on Trade and Development (UNCTAD), China has long been a ‘rule taker’ more than ‘rule maker’. In the recent past, India has often resisted certain trade

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evolutions in relation to agriculture, services or intellectual property with, for example, along with Brazil and South Africa, the drafting of the Doha Declaration on the TRIPS agreement and public health of November 2001, and the Protocol amending the TRIPS agreement in 2005.\textsuperscript{415}\textsuperscript{416} Far from being a passive actor in normative integration however, China has learned to act by observing the strategy of other members and is now at the forefront of WTO dispute settlement, not only as far as the number of disputes is concerned, but also with regard to the legal strategy it develops to juggle with the flexibilities envisaged in the WTO agreement, hence surprisingly managing to reactivate the customary principle of permanent sovereignty over natural resources.\textsuperscript{417} These arguments, together with the principles of ‘equity and common but differentiated responsibilities’ as applied to climate change negotiations, now find a real echo among developing countries.\textsuperscript{418}

With shrewd negotiating skills and strategic advocacy, India and China have been able to use the existing trade regime as a tool of their might. Shunning the paths marked by regulated liberalism of the 1990s, they affirm a heterodox model, which partly stands out and appeals to developing countries seeking alternatives to a Washington consensus, which has failed to bring the development benefits expected. At a chosen pace, their selective and critical normative integration has contributed to their political autonomy and this is particularly true in the area of

\textsuperscript{415} See <https://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_trips_e.htm> accessed 17 August 2015.

\textsuperscript{416} See <https://www.wto.org/english/tratop_e/trips_e/wtli641_e.htm> accessed 17 August 2015.

\textsuperscript{417} See in particular the WTO disputes DS394 China — Measures Related to the Exportation of Various Raw Materials <https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds394_e.htm> accessed 17 August 2015. See also DS 431 China – Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum <https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds431_e.htm> accessed 17 August 2015.

\textsuperscript{418} See the BRICS 2015 Environment Ministers Declaration <http://www.brics.utoronto.ca/docs/150422-environment.html>: ‘We recognize that sustainable development should comprehensively address the key challenges of today, in particular, poverty eradication, changing unsustainable and promoting sustainable patterns of consumption and production, protecting and managing the natural resource base of economic and social development and effectively addressing climate change. We reaffirm our commitment to implement the Rio Declaration, Agenda 21, the Johannesburg Plan of Implementation (JPOI), and the outcomes of the Rio +20 Conference in our respective countries, and through our cooperation within the framework of BRICS in accordance with the Rio principles, including the principle of common but differentiated responsibilities.’
international investment law, a key domain of sovereign independence now at the
centre of a renewed international attention.

International investment law and dispute settlement is indeed constantly evolving
from a conceptual framework to a variety of other approaches, which may
apparently refer to the same standards but greatly differ in putting forward policy
objectives and economic development paths.\textsuperscript{419} In recent years, profound changes
have occurred, hence modifying the landscape designed by the proponents of the
1990s investment liberalization: countries like Ecuador, Bolivia or Venezuela have
denounced the International Convention for the Settlement of Investment Disputes
(ICSID) and some of their Bilateral Investment Treaties (BITs), as exemplified by
Ecuador’s March 2013 decision to terminate its BIT with the US, a few months
after a record USD 2.3 billion award against Quito in the \textit{Occidental Petroleum
Corporation v Ecuador} case.\textsuperscript{420} Another revealing example was provided, in early
2013, by India when it decided to suspend all its BITs negotiations to eventually
publicly release a first new BIT model draft, which has largely been commented
since the beginning of 2015.\textsuperscript{421} This did not come as a complete surprise as India
has been facing, for the past 5 years or so, a growing number of investors’ claims
(around 17 according to certain estimates).\textsuperscript{422} Some of these disputes, and the
landmark decision on the \textit{White Industry} case to start with, have literally produced

\textsuperscript{419} See R. Echandi and P. Sauvé (eds), \textit{Prospects in International Investment Law and Policy}, World

\textsuperscript{420} Convention on the Settlement of Investment Disputes between States and Nationals of Other
States (the ICSID Convention or the Convention) entered into force on 14 October 1966; \textit{Ecuador in Occidental
Petroleum Corporation v Ecuador}, ICSID Case No. ARB/06/11. It has been reported that this is the largest sum ever awarded by a tribunal under the ICSID Convention
and, unsurprisingly, has been challenged by Ecuador. This controversial dispute arose out of
Ecuador’s April 2006 decision to terminate, by way of a decree the Participation Contract
under which Occidental Petroleum Corporation (Occidental) and Occidental Exploration and
Production Company (OPEC, the Claimants, were exploiting oil in the Oriente Basin in the
Ecuadorean Rainforest (the same region where the Chevron- Texaco case took place). While
the 3 arbitrators of the tribunal were unanimous on the liability of Ecuador (breach of the
contract and violation of the US-BIT in acting disproportionate manner), Professor Brigitte
Stern firmly and brilliantly dissented upon the calculation of damages. On the basis of this
dissenting opinion Ecuador is said to plan to seek annulment of the award. She indeed argues
that the Claimant himself contributed to the damage causing the contract termination by
Ecuador.

\textsuperscript{421} See <https://mygov.in/group-issue/draft-indian-model-bilateral-investment-treaty-text/> accessed 17 August 2015.
a landslide of comments and interrogations on the direction to be given to India’s investment policy with regard to some essential aspects of its autonomy to regulate economic activities including its tax policy. 423 At the centre of a global controversy, indeed, investor-state dispute settlement has radically changed. While the number of disputes has exploded with 42 new cases introduced in 2014, hence bringing the total number of known treaty-based cases to 608, the geographical repartition as well as the nature of the cases have dramatically evolved. 424 As far as countries targeted by investment arbitrations are concerned, an important evolution is under way: with 40 per cent of new cases initiated against developed countries, the relative share of cases against these countries has been on the rise (compared to the historical average of 28 per cent) and this has already impacted the discussion on investment arbitration, including the EU’s reluctance to introduce investment arbitration provisions in the agreements it is currently negotiating and the TTIP precisely. As far as the nature of disputes is concerned, investors do not hesitate anymore to target host countries’ regulatory activity in challenging national policies for health, the environment, or energy production and security. 425 In addition, the latest rendered awards have reached incredible amounts with a 2014 award of USD 50 billion, the highest known award by far in investment arbitration, in the Yukos three closely related cases. 426 So that the concerns with the current investors-state dispute settlement (ISDS) system are based on a number of clearly identified issues:


423 We will further develop the White Industry case’s impact on the Most Favoured Nation (MFN) standard of treatment below. The White Industry case Final Award is available at <http://www.italaw.com/sites/default/files/case-documents/ita0906.pdf> accessed 17 August 2015.


a democratic deficit coupled with a deficit of legitimacy in relation to the questionable professionalism, independence and impartiality of arbitrators and the lack of transparency in the proceedings and publication of decisions; a deficit of coherence and consistency in the arbitral awards; third parties financing; the cost of arbitration, and finally the absence of an appeal mechanism. 427

Since all these developments are affecting Asia directly at a time it has become the main global investor, this article focuses on Chinese and Indian FDI in developing Asia as a laboratory of the global investment standards battle and pays particular attention to the National Treatment (NT) standard as a fascinating example of the state’s ability to exercise its sovereignty in regulating essential domains. Starting from a historical and conceptual perspective shedding some light on the different phases of the standard of treatment’s acceptance and denial (I), the research develops into a critical examination of the national treatment standard and a substantial analysis of the scope and application of this very standard in Chinese and India Asian IIAs as a concrete and effective alternative to currently proposed solutions based on the limited and often tautological ideas of states’ autonomy to regulate and other novel ‘flexibilities’ (II). Lastly, as a conclusion, it argues in favour of a more strategic use of the national treatment standard, and the qualifications/exceptions it assumes, to foster states sovereign economic paths and development strategies.

427 See for quite critical study, P. Eberhardt and C. Olivet, ‘Profiting from Injustice, How Law Firms, Arbitrators and Financiers are Fuelling and Investment Arbitration Boom’ (2012), Corporate Europe Observatory and the Transnational Institute.
I. NATIONAL TREATMENT: A RELATIVE STANDARD AND POLITICAL SENSITIVE ISSUE

International investment standards of treatment have successively taken a large variety of sophisticated yet sometimes ambiguous shapes from the classical non-discrimination principles commonly manifested in the national treatment (NT) and most-favoured-nation (MFN) treatment to a customary minimum standard of treatment now often expressed in terms of a broader treaty based ‘fair and equitable treatment’ (FET), which has gained worldwide prominence but remains (in investment law particularly) problematic with regard to the very extensive interpretation of states obligations it encourages. Although less debated than the controversial FET, the national treatment standard today deserves to be carefully reinvestigated as it poses a number of fundamental questions in relation to the balance between the state’s autonomy to regulate foreign trade and investment liberalization for public interest and sovereign economic development, and private actors’ legitimate expectations of market access, protection and equality of treatment. While the national treatment standard is now largely enshrined in international trade and investment agreements, it has gone through different phases of acceptance and denial, which deserve to be put in perspective with regard to today’s large variety of international instruments and players. In addition, a careful review of some of the recent treaties’ incarnations of the national treatment standard highlight its relative nature and flexible character in relation to other standards of treatment and a number of complicated issues including investment admission and establishment at all government levels. Lastly, an assessment of the available investment jurisprudence provides for some clarification, but these decisions are neither sufficiently varied nor consistent enough to produce an accurate analysis of a predictable application and possible interpretation of the national treatment standard.

A. FROM DENIAL TO UNIVERSALIZATION

While the whole international law system rests upon states sovereignty and its corollary of equality amongst states, the responsibility of host states to foreigners has never been easy to conceptualize, nor universally accepted.\textsuperscript{430} Late 19th century western practices tend to show that aliens were entitled to equality of treatment with nationals of the host state, but the protection of their property, already proclaimed as an unalienable right by the 1789 French Declaration of the Rights of Man and the Citizen, remained ambiguous. Prior to the 1917 Russian Revolution and the abolition of private property without compensation, the Calvo doctrine – often confused with the Calvo clause one could find in a number of Latin American Constitutions and other international investment agreements – gave an excellent account of the competing approaches to state responsibility in international law. The work of Carlos Calvo, the famous Argentine jurist, is indeed systematically referred to in international investment law publications to explain the reluctance of States, and Latin American States in particular, to grant a more favourable treatment than the treatment they accorded to their nationals. But what was Carlos Calvo writing in his 1868 Derecho International Teorico y Practico de Europa y America and his further elaborated 1896 French edition Le droit international : théorie et pratique? Not that much about private property and international investment, as suggested by his many critics, but rather about states’ equality, sovereignty and independence in the context of solvency crisis and the many attempts by western States to resort to the use of force to collect debt as exemplified by the US ‘gunboat diplomacy’ performed in the 1980s in Venezuela. Out of this rather simple ‘Calvo doctrine’ a number of Latin American countries developed a ‘Calvo Clause’ introduced in their Constitutions (the post 1917 Mexican Consitution being characteristic of this trend) or indeed in some of the contracts they concluded with aliens. These legal instruments more specifically argued in favour of a strict approach to national treatment as the best possible treatment accorded to foreigners who would then refrain from resorting to other

dispute settlement mechanisms than those available at the domestic level while leaving aside the possibility of calling for diplomatic protection from their home State. So that the famous Hull formula, named after the US Secretary of States, had to firmly express the American view (and most probably the western views of that time) of the rights and obligations of host states to foreign investors, and their home States in general, and the protection of private property in particular. As far as the national treatment standard was concerned, nothing was codified and the unwritten rules of customary international law prevailed. One had to wait for the drafting of the – never adopted as too ambitious (trade, investment, labour, environment) – Havana Charter to find some national treatment related provisions as shown by its Article 12 (International Investment for Economic Development and Reconstruction). The waves of expropriations following the Socialists’ revolutions, in Eastern Europe and in the Third World, as well as the decolonization era, forced international investment players to rethink the customary legal basis upon which international investment law rested. A fascinating first attempt took place within the United Nations General Assembly. From the 1962 Resolution 1803 on Permanent Sovereignty over Natural Resources to the 1974 Declaration on the Establishment of a New International Economic Order (NIEO) and the 1986 proclamation of the Right to Development, developing States started to elaborate a special approach to international trade and investment, which today deserves to be reconsidered as it already showed some of the challenges resulting from a fast paced economic internationalization. While the 1803 Resolution eventually proved quite consensual in affirming a number of fundamental principles such as the payment of compensation, in accordance with international law, in the event of a taking of alien property for public interest, as well as the possibility of resorting to international dispute settlement mechanisms after exhaustion of local remedies, this apparent international consensus did not


433 See General Assembly Resolution 3201 (S-VI), Declaration on the Establishment of a New International Economic Order, 1 May 1974.

434 See General Assembly Resolution 41/128, Declaration on the Right to Development, 4 December 1986.
last for long. The adoption, in December 1973, of the General Assembly Resolution 3171, and, even more importantly, of the 1974 Charter of Economic Rights and Duties of States designed to support the NIEO, lifted all ambiguities. The approach was clearly not sympathetic toward a liberal model promoting states’ opening-up policies. Although the text of the Charter remains of a general and non-binding nature and cannot be compared to precise treaty provisions, it is clear that: ‘no State shall be compelled to grant preferential treatment to foreign investment’ and ‘where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means’. In this context, national treatment, including domestic settlement of disputes, was considered the best available standard of treatment expressing a cautious approach to an economic liberalization, which did not always prove beneficial to the developing world. Interestingly, a rather different, if not opposed, perspective to liberalization was also adopted, in the same key period, with the drafting of the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States. As history has shown, this liberal approach favouring investor protection won out over the 1970s NIEO. However, as far as national treatment was concerned, this international transformation of economic relations was neither as evident as some seemed to analyze it, nor was it systematically supporting a ‘goal of equal opportunity’ hence caring about ‘the fate of human without seeking egalitarianism’. Nevertheless, the liberal view was crystallized, in the 1990s, in a variety of international instruments that soon became the apparent normative references of international trade and investment law from the WTO ‘constitution’ itself to a blossoming number of international investment instruments. The 1992 Preamble of the World Bank’s Guidelines on the Treatment of Foreign Direct

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436 ibid Article 2, para. a.
437 Charter of Economic Rights and Duties of States (n 30) Article 2, para. c.
Investment set the tone in praising the positive role of foreign direct investment for the world economy and developing countries in particular. It was rapidly followed by a surge in BITs and, very importantly, the negotiations of a vast number of investment treaties by all major Asian states (China, India, South East Asian nations). Amongst these international investment initiatives, three instruments are particularly revealing of the 1990s spirit with regard to the national treatment standard: the OECD National Treatment Instrument, the NAFTA, and the Energy Charter Treaty. These three international instruments designed for the greatest protection of foreign investment in a post-socialist era promoting trade and investment liberalization greatly influenced the drafting of specific IIAs and BITs in particular. The 1994 NAFTA Treaty Chapter 11 defining national treatment in its famous Article 1102 as follows is quite revealing of the spirit of that time:

1. Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favourable than the most favourable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.

4. For greater certainty, no Party may:

   (a) impose on an investor of another Party a requirement that a minimum level of equity in an enterprise in the territory of the Party be held by its nationals, other than nominal qualifying shares for directors or incorporators of corporations; or
require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment in the territory of the Party.

As we will see below, this Article has been extensively interpreted in a rather broad, yet often inconsistent manner, hence providing the basis for national treatment jurisprudence. Along the same lines, the 1994 Energy Charter Treaty reformulated the national treatment standard (together with the MFN standard) quite synthetically:

Each Contracting Party shall endeavour to accord to Investors of other Contracting Parties, as regards the Making of Investments in its Area, the Treatment described in paragraph (3).

For the purposes of this Article, “Treatment” means treatment accorded by a Contracting Party which is no less favourable than that which it accords to its own Investors or to Investors of any other Contracting Party or any third state, whichever is the most favourable.439

With new environmental and human rights challenges arising from multinational corporations’ operations, but also the rise and consolidation of non-western super economic powers, which have taken a different road towards trade and investment liberalization, the 2000s offer a much more diverse picture for both investment and trade. In this fragmentation of international economic law440 at various regional levels, one can however identify a number of interesting tendencies showing economic actors’ preoccupations with much more than simple liberalization.441 Although never really consistent and sometimes contradictory, these evolutions are visible at the BITs level, but also in the context of the now very popular FTAs, which integrate a substantial investment chapter, not to mention all the

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megaregional deals recently concluded or negotiated.⁴⁴² As far as BITs are concerned, the same proponents of the 1990s investment liberalization are currently introducing what some have described as ‘smart flexibility clauses’ in their new IIAs.⁴⁴³ The 2012 US and Canada BIT models are indeed very well playing with states’ regulatory autonomy for public purposes while incorporating some additional flexibility/protection in relation to labour, corporate social responsibility and the environment.⁴⁴⁴ In these new models, the national treatment standard is defined as a straightforward way illustrated by the US 2012 BIT model Article 3:

National Treatment:

1. Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.

2. Each Party shall accord to covered investments treatment no less favourable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

3. The treatment to be accorded by a Party under paragraphs 1 and 2 means, with respect to a regional level of government, treatment no less favourable than the treatment accorded, in like circumstances, by that regional level of government to natural persons resident in and enterprises constituted under the laws of other regional levels of government of the Party of which it forms a part, and to their respective investments.

⁴⁴³ See A. van Aaken, ‘Smart Flexibility Clauses in International Investment Agreements’ (2013) 3(4) Investment Treaty News, pp 3-5.
All levels of government are concerned and the national treatment standard is granted post-establishment or, if granted pre-establishment, as illustrated by the US-China investment discussions generated by the business lobby, it is done in a hybrid manner based on a list of industry sectors, which could benefit (or not) from this particular standard before they enter the country. Generally, NAFTA jurisprudence lessons have been learned and developed States have understood that their political autonomy and social stability could also be threatened by IIAs that are too friendly. In addition, the new models, and the Canada 2012 BIT model especially, provide a good example for the possible usage of exceptions. The exception provisions are indeed quite detailed while departing from the previous Canada BIT model, which was very much inspired by the GATT Article XX and its famous chapeau some - as argued in NAFTA jurisprudence – feel difficult to apply to an investment context. This new approach finds an interesting application in the recent Canada-China BIT that opens with a preamble recognizing the need ‘to promote investment based on the principles of sustainable development’ and contains a long list of exceptions covering a large variety of domains from cultural industries to environmental, financial or transparency issues. Interestingly, this autonomy to regulate in a flexible, yet justifiable manner, seems to be challenged by the freshly negotiated EU-Canada Comprehensive Economic and Trade Agreement (CETA). As far as non-discrimination is concerned, the draft provisions recently made public indeed seem to couple pre-establishment requirements together with more traditional non-discrimination measures. This combination could de facto limit the use of exceptions in furthering the obligations

445 The GATT Article XX (General Exceptions) ‘Chapeau’ indeed states: ‘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’.


of host states towards investors in the pre-establishment phase. That FTAs or regional IIAs negotiations contradict or limit other bilateral investment negotiations conducted in parallel is not a surprising phenomenon. The incredible surge in FTAs, and regional IIAs in general, produces such oddities. Similar questions are raised about the coexistence of not completely dissimilar, yet not exactly identical, investment provisions – and national treatment clauses in particular – present in some of the recently concluded FTA including a detailed investment chapter, such as the 2009 ASEAN-Australia-New-Zealand FTA Chapter 11, the Central-America Mexico FTA (2011) the China–Japan–Republic of Korea investment agreement (2012) or the recently signed ASEAN–India Trade in Services and Investment Agreements, and other IIAs the same countries are parties to. Some of these agreements, as the Central-America Mexico FTA, contain detailed lists of exceptions directly framing the application of the national treatment standard. Without clarification of the relationship and hierarchy between new and old treaties, the application of the exceptions clauses as well as the interpretation of possible national treatment breaches will remain as complicated as it is uncertain. Some investment actors will naturally play with this great diversity in looking for the best possible combination, while others, including emerging States and developing States especially, will suffer from a lack of stability and predictability.

448 Section 3 of the Investment Chapter (10), Non-Discriminatory Treatment - Article X.6.1 National Treatment reads as follows:

1. Each Party shall accord to investors of the other Party and to covered investments, treatment no less favourable than the treatment it accords, in like situations to its own investors and to their investments with respect to the establishment, acquisition, expansion, conduct, operation, management, maintenance, use, enjoyment and sale or disposal of their investments in its territory.

It has to be read in conjunction with the Article X.4 Market Access as well as the quite detailed investment reservation lists (from aboriginal population protection to gambling sector) annexed to the treaty.


As far as clarification is concerned, the NT jurisprudence has only provided for relatively limited clarifications as it relies on a small number of cases and suffers from a lack of consistency. The most significant cases are indeed based on the North American Free Trade Agreement (NAFTA) Article 1102, which de facto limits the interpretation to a very specific context at a time the national treatment standard was essentially envisaged as a barrier against state’s protectionism. While some of the tribunals have found in favour of the state’s autonomy to regulate for public interest – in relation to environmental issues mostly - the legal reasoning followed by the arbitrators did not prove consistent, if not in absolute contradiction, as exemplified by the diametrically different Metalclad and Methanex decisions. However, some major directions are identifiable.

The first test of international investment standard interpretation generally consists in the determination of discrimination. In our case, national treatment violation is seemingly an easy task: first comes the determination of a differentiation (de jure or de facto) in terms of treatment accorded to the foreign investment and/or investor, then it has to be demonstrated whether the foreign investment and/or investor are placed in a comparable situation (“like circumstances” or “like situation”) to the domestic one. But this simple last test comes with many complications. Let us briefly address this important issue in highlighting some of its essential features:

In the first substantive analysis of a national treatment claim in an investor-state dispute, the SD Myers Inc v. Canada tribunal considered that the general principles

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453 See Central-America Mexico FTA, Chapter XX, Exceptions and article 20.2 General Exceptions. Available at <http://www.sice.oas.org/Trade/CACM_MEX_FTA/Text_s.asp#Art%C3%ADculo11.4> accessed on 17 August 2015.

454 See for example, J. Elcombe, 'Regulatory Power v. Investment Protection under the NAFTA: Chapter 1110: Metalclad, Methanex and Glamis Gold' (2010) 68(1) University of Toronto Faculty of Law Review. The Glamis case also involved environmental issues of special importance. Glamis Gold Limited (the claimant) is a Canadian-based mining company that had obtained an authorization to develop a mine site in California using open pit techniques. To protect the Native American religious and cultural heritage sites, California adopted a set of more stringent rules. So that Glamis alleged that the US breached their NAFTA obligations under Article 1105 (fair and equitable treatment) and Article 1110 (expropriation). The tribunal rejected all claims and found in favour of the US.

456 SD Myers Inc v Canada, First Partial Award, 13 November 2000, para 250.
'emerging' from the legal context of NAFTA were to be taken into consideration to interpret the expression “like circumstances”. It argued:

that the interpretation of the phrase “like circumstances” in Article 1102 must take into account the general principles that emerge from the legal context of the NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns. The assessment of “like circumstances” must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest. The concept of “like circumstances” invites an examination of whether a non-national investor complaining of less favourable treatment is in the same “sector” as the national investor. The Tribunal takes the view that the word “sector” has a wide connotation that includes the concepts of “economic sector” and “business sector.”

From this interpretative elaboration, just like in trade law, a link was made between likeness and competition. Competition (amongst other elements) appears as a condition of likeness. A similar reasoning can be found in the Pope & Talbot decision. However, just like in trade law again, subsequent decisions did not necessarily support this approach. In Occidental v Ecuador as well as in the much-debated Mehtanex v US, the tribunals departed from a competition based analysis of the national treatment standard and failed to provide for an alternative. Despite further sophistication, including frequent references to WTO jurisprudence and the role that Article XX (general exceptions) could play, the absence of consistency and coherence in arbitral reasoning is evident, and so the need to approach these decisions with great care as they involve considerable political elements, which go far beyond simple treaty interpretation and the protection of investment and/or the state’s autonomy to regulate in favour of environmental protection. This politically strategic usage of the national treatment standard has proved to be particularly true in the different sequences of denial, acceptance and distantiation operated by China and India in the course of their internationalization from FDI recipients to FDI exporters.

457 Pope & Talbot, para. 78.
FOCUS

Developing Asia as Global FDI Leader

FDI Inflows by region, 2012-2014 (billion of dollars)

FDI Outflows by Group of Economies and Regions, 2012-14 (billions of dollars)
According to the 2015 UNCTAD World Investment Report, most economies experienced a fall in FDI inflows in 2014. But two Asian groups resisted the fall: the Association of Southeast Asian Nations (ASEAN), with a 5% increase in FDI inflows, and the Regional Comprehensive Economic Partnership (RCEP), with a 4% increase. In addition, in 2014, multinational enterprises (MNEs) from developing economies alone invested $468 billion abroad, a 23% increase from the previous year and their share in global FDI reached a record 35%, up from 13% in 2007. MNEs from developing Asia revealed extremely dynamic and, for the first time, developing Asia became the world’s largest investing group with outward investment increased by 29% to $432 billion in 2014. MNEs from Hong Kong (China) jumped to a historic high of $143 billion, hence positioning Hong Kong as the second largest investor after the United States. Interestingly, investment by Chinese MNEs grew faster than FDI inflows into China, reaching a new high of $116 billion. In South-East Asia, FDI outflows from Singapore increased to $41 billion. In South Asia, FDI outflows from India increasing fivefold to $10 billion. Lastly, Investments by Turkish MNEs almost doubled to $7 billion.

II. THE NATIONAL TREATMENT STANDARD IN CHINESE AND INDIAN ASIAN IIAs

A. A SEQUENTIAL APPROACH TO STANDARDS INTEGRATION

Before we delve into the study on the national treatment standard in Chinese and Indian Asian IIAs, let us take time to briefly examine how these two countries have dealt with other major standards of treatment over the years to better frame their evolving relationships with FDI promotion and protection. With 130 BITs and 17 other IIAs for China and 84 BITs and 13 other IIAs for India, the two countries have been at the forefront of treaty negotiations for the past 3 decades. For China, see <http://investmentpolicyhub.unctad.org/IIA/CountryBits/42#iaInnerMenu>; For India see http://investmentpolicyhub.unctad.org/IIA/CountryBits/96#iaInnerMenu> accessed on 17 August 2015.

Interestingly, the changing nature of their trade from closed socialist economies to more liberal and internationalized paradigms have naturally impacted their perceptions of the best possible treaty as much as their recent encounters with international investment arbitration and the challenges this de-territorialized way
of settling dispute may pose to sovereignty. So their recent attempts to review their BITs and other IIAs in a manner they feel is better suited to today’s economic needs and political realities.

As far as China is concerned, one generally identifies 3 moments, if not 3 generations of IIAs. The initial phase started with China’s first BIT with Sweden, in 1982, and lasted until the late 1990s. It was largely characterised by a prudent, if not reluctant, approach to normative internationalization, with NT seldom granted and international dispute settlement limited to the determination of the amount of compensation for expropriation. From 1998 on, with the China-Barbados BIT of July 1998 that offered, for the first time, foreign investors unrestricted access to international arbitration, China entered into a new phase of BIT drafting inspired by EU model treaties and framing NT in a less restrictive and somehow personalized manner depending on whether the country was a developed or developing nation. The last phase, starting from 2007 and the China-Korea BIT, is generally described as a more liberal one partly inspired by NAFTA in the sense that Chinese treaties granted Fair and Equitable Treatment (FET) in de facto accepting certain customary international law features, but also the national treatment and MFN often defined in using the now generalized yet difficult to interpret “in like circumstances” terminology. To these three generations, I would add a fourth one corresponding to today’s mega-regional trade and investment negotiations and China’s expansion as a global investor. As we will see below, this fourth generation may well be characterized – and this is not China specific – by a certain distancing from the late 1990s NAFTA model in relation to today’s new investment issues. In addition, it integrates the lessons learned from China’s accession to and participation in the WTO. Lastly, the recent wave of

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FTA drafting does not seem to add much to China’s general BIT approach on the contrary to some thesis often put forward and according to which a regional negotiation’s aim is to further liberalize trade in introducing greater protection and flexibilities.\(^{462}\)

Although a relative latecomer on the BIT scene with a first treaty signed with the UK in 1994, India has progressively developed a very large number of treaties with developed and developing countries all over the world. While it restricted itself to BITs until 2004, it then accepted to enter into regional negotiations and FTA with countries such as Japan, Korea and Malaysia (see the below table) and there are many more to come at the bilateral or mega-regional level. Interestingly, India took an opposite stance to China as far as NT and MFN are concerned. While it generally granted the two standards of treatment (as well as FET) in most of its 1990s and 2000s treaties, its recent attempts show a real suspicion against the MFN. This, of course, is a direct result of its novel – and first – condemnation by an arbitral tribunal in the *White Industry* case. While based on the India-Australia BIT, the enlarged interpretation of the MFN standard by the investment tribunal resulted in the finding that the standard of ‘effective means of asserting claims and enforcing rights’ could be found in India-Kuwait BIT.\(^{463}\) It then concluded that: ‘The Republic of India has breached its obligation to provide effective means of asserting and enforcing rights with respect to the White Industry Australia Limited’s investment pursuant to the article 4(2) of the BIT incorporating the article 4(5) of the India Kuwait BIT.’\(^{464}\) For these reasons, and because, as we have seen many other relatively similar (tax related) cases underway, the Indian government has decided to review its BIT policy including its BIT model, the latest draft having no mention of the MFN standard, which may pose problematic for Indian investors going global.\(^{465}\)

\(^{462}\) See Axel Berger, (n 57).

\(^{463}\) Art 4(5) of the India-Kuwait BIT provided that: ‘Each party shall ... provide effective means of asserting claims and enforcing rights with regard to investments ... Each Contracting State shall maintain a favourable environment for investments in its territory by investors of the other Contracting State... Each Contracting State shall in accordance with its applicable laws and regulations provide effective means of MFN.’

\(^{464}\) See The White Industry Final Award at 16.1.1.

\(^{465}\) On the recent developments and pros and cons of an MFN insertion, see Prabhash Rajan, ‘Most favoured nation provisions in India BIT, a case for reform’, (2015) Indian Journal of International Law, Online test issue.
b. National Treatment: From Contestation to Adoption and Distanciation China Asian IIAs and NT

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<th>Agreement</th>
<th>NT Standard</th>
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As we understand from the previous developments and the tables above, major emerging economic players such as China\textsuperscript{466} and India (to a lesser extent)\textsuperscript{467} did not initially grant the NT standard to foreign investors in order to protect certain strategic economic sectors and so that their own populations at the entrepreneurial or individual level. China for instance has had a very progressive integration of the NT standard, first granting it (with qualification/exceptions) to developed countries and then to developing countries. The China-India BIT is in this regard revealing as its article 4 strikes an interesting balance between the two countries perspectives:

**Article 4:** (National Treatment and Most-Favoured-Nation Treatment)

1. Each Contracting Party shall accord to investments of investors of the other Contracting Party, treatment which shall not be less favourable than that accorded either to investments of its own investors or investments of investors of any third State.

2. In addition, each Contracting Party shall accord to investors of the other Contracting Party, including in respect of returns on their investments, treatment which shall not be less favourable than that accorded to investors of any third State.

3. The provisions of paragraph (1) and (2) above shall not be construed so as to oblige one Contracting Party to extend to the investors of the other Contracting Party the benefit of any treatment, preference or privilege resulting from:

   (a) any existing or future customs unions, or similar international agreement to which it is or may became a party, or

   (b) any matter pertaining wholly or mainly to taxation. Such taxation matters shall be governed by the Agreement between the Republic of India and the People’s Republic of China for Avoidance of Double taxation of 18-7-1994.


The China-Australia 2015 BIT offers a renewed vision of the NT with the notable reference to the term ‘in like circumstances’:

**Article 9.3: National Treatment**

1. **Australia** shall accord to investors of **China** treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.

2. **China** shall accord to investors of **Australia** treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the expansion, conduct, operation and sale or other disposition of investments in its territory.

3. **Australia** shall accord to covered investments treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.

4. **China** shall accord to covered investments treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the expansion, management, conduct, operation and sale or other disposition of investments in its territory, investments with respect to the management, conduct, operation, sale or other disposition of Investments in its territory.

Lastly, the NT article of the 2015 draft Indian BIT model showed some distancing from the general phrasing and underlined the possibility of exceptions:

4.4 **Exercises of discretion**, including decisions regarding whether, when and how to enforce or not enforce a Law shall not constitute a violation of this Article provided such decisions are taken in furtherance of the Law of the Host State.

4.5 Extension of financial assistance or Measures taken by a Party in favour of its investors and their investments in pursuit of legitimate public purpose including the protection of public health, safety and the environment shall not be considered as a violation of this Article.
This heterodox strategy eventually emerged positive as it gave space for regulatory autonomy and gradual economic liberalization in supporting the development of national champions now ‘going global’ as they claim, in turn, the national treatment standard of protection. To explain this, one has to bear in mind the revolutionary nature of a national treatment directly impacting on states’ regulatory autonomy and domestic constitution. Granting national treatment to foreigners can indeed be seen as a profound contribution towards universalism by means of a concrete adherence to international law, but it can also be interpreted as too intrusive a standard that a State is not able to adhere to in view of its economic development or the lack of reciprocity its nationals may de facto face in the absence of either corresponding foreign regulations or economic capacity to trade and invest abroad. So there is reluctance by many, in view of political and pragmatic considerations, to take such a fundamental turn in their approach to opening up and globalization.

CONCLUSION

Now widely accepted, the national treatment standard is present, at the post-entry stage, in all Chinese and Indian FTAs and IIAs, coupled (or not) with other investment standards and the MFN and FET standards in particular. Pre-entry national treatment provisions modelled on US practice are not generalized because many countries, and emerging countries in particular, are resisting their introduction to protect their regulatory autonomy. While of a limited nature in the 1990s BITs, exceptions are now often introduced in the new IIAs including by developed States firmly supporting investment liberalization. China and India should make a larger use of these. Of various nature, these exceptions can be general (public health, order, moral, security) and influenced (or not) by the GATT Article XX general exceptions provision, but they can also be country specific to protect nationals against foreign investment in certain economic fields (infant industry, strategic economic sectors such as the cultural industry) or target specific domains for exemption of national treatment (intellectual property, prudential measures, financial services).

The qualifications/exceptions to the national treatment serve as a regulator to balance the legal symmetry sometimes artificially created by the national treatment standard with the economic asymmetries resulting from a de facto dominance from one partner’s powerful multinational companies over the other partner’s economy. Thus the national treatment standard effectively induces and supports a sovereign to develop itself by an autonomous regulatory project. In addition, a smart and efficient use of regulatory flexibilities could reconcile different approaches in trade and investment law. In this regard, a positive reconsideration of the national treatment standard by China and India and the many possibilities it offers to enhance state sovereignty in their economic choices would contribute to the very objective of a regulated trade and investment liberalization - a globalization beneficial to all.
Recognition and Responsibility: 
A Legislative Role for Transnational Corporations in 
Public International Law — 
Thoughts from the Perspective of Human Rights 

By 
Stefan Kirchner* 

ABSTRACT 

Transnational Corporations (TNCs) provide goods, services, jobs and tax income for states and are an essential factor of the globalized economy. At the same time are many TNCs so powerful that it has become impossible for some nation states to regulate them adequately. In particular, in cases of human rights violations, TNCs can be under-regulated perpetrators. For a long time, there have been efforts to ensure that TNCs can be held accountable even if their economic power exceeds the political and regulatory powers of nation-states. So far, international law has had limited success in this regard. Public International Law might be more effective in reaching TNCs if TNCs would have a more open role (as opposed to lobbying states) in creating new rules of international law. It is suggested in this article that TNCs can have a role in the legislative process. The shortcomings of the current legal system will be shown as well. In addition, the text will provide considerations based on human rights and international constitutional law as to why this should not yet happen at this time. 

Keywords: Globalization, Transnational Corporations, Public International Law, Law-Making.

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Globalization is often perceived as economic globalization.\(^{469}\) This view is, of course, too narrow\(^{470}\) but for the purposes of this paper, I would like to focus on this particular aspect of globalization, specifically, on the role of transnational corporations (TNCs) in Public International Law (PIL)\(^{471}\). TNCs are a driving force of globalization\(^{472}\) and play an increasingly important role not just in economic terms but also for the societies in which they operate as well as for the society at large. TNCs are at times involved in human rights violations.\(^{473}\) Often

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the economic power of a TNC will surpass that of states, which highlights the possibility of state-dependency and correspondingly, the lack of effective protection of human rights as against corporations. TNCs might even evade national rules. 474

Further, transnational economic activities are more difficult to regulate than the purely domestic economic activities of corporations. 475

TNCs have a legal status as well as a legal personality. 476 Usually, though, this legal personality is based on domestic law. For a sufficiently large global company, no single national market, not even China’s, is in itself indispensable. This theoretical dependency on national law and the factual impotency of many nation states make it necessary to ask about the international legal position of TNCs. At the same time, it also becomes imperative to consider whether globalization leads to an entirely new system of international law. 477 It will be shown that the globalized international law which has emerged in the last quarter of the century essentially builds on the Post-Westphalian model of international law which has emerged since 1945.

TNCs are an essential element of the global economy, not only as providers and recipients of goods and services, but also as employers and tax payers. The important role of TNCs today though, is not yet adequately reflected in the status that they enjoy under international law. The economic role of TNCs is not reflected in their political or legal role. This comes as no surprise because, globally speaking,

474 D. Thurer, ‘The Emergence of Non-Governmental Organizations and Transnational Enterprises in International Law and the Changing Role of the State’, in Rainer Hofman (ed.), Non-State Actors as New Subjects of International Law (1st ed., Duncker & Humblot, Berlin 1999), 37, 49

475 L. Catá Backer, ‘Multinational Corporations as Objects and Sources of Transnational Regulation’s Ob’ <http://ssrn.com/abstract=925679>

476 Ibid. 6.

477 Cf. 20.
politics is characterized by fragmentation\textsuperscript{478} whereas economics is “integrated”:\textsuperscript{479}

It appears easier to break down trade barriers than political barriers. The history of integration in what is today the European Union (EU) is a good example for this. What began as an economical project (\textit{albeit} with a view to securing peace between the partner states) has evolved into a much more ambitious and in many ways, also apolitical project.

The question we have to answer in this context is not the utopian one of whether non-state actors can or should become subjects of public international law on an equal footing with the states. Rather, our question has to be whether we can increase the acceptance of international legal standards applicable to TNCs by allowing TNCs a greater say in their creation.\textsuperscript{480}

\section*{B. Responsibility of Transnational Corporations Under International Law}

TNCs pose a significant challenge for Westphalian-style Public International Law which is still very much centered on the state. Rather than understanding international law in times of globalization as a sudden and complete overthrow of the existing legal order, this development might be described more adequately as a gradual change, \textit{albeit} a fast one.\textsuperscript{481} The most notable feature of this change is of course the development of International Human Rights Law. However, while International Human Rights Law gives individuals a certain status under international law, it does not elevate them to the status of full subjects who could decide on the creation of new rules. At the same time, the evolving international legal order today also includes obligations for non-state actors, most notably, but by no means limited to, International Criminal Law.

\textsuperscript{478} Thurer, \textit{supra} (n7)48.
\textsuperscript{479} Ibid.
\textsuperscript{480} This approach was first proposed by the author in S. Kirchner, \textit{supra}, (n4), as well as later in S. Kirchner, \textit{supra}, (n2)
So far, TNCs are mainly the object of non-binding codes of conduct such as those created by the International Labour Organization (ILO) or the Organisation for Economic Co-operation and Development (OECD). Another key example is the “Norms on the responsibilities of transnational corporations and other business enterprises with regard to human rights”. The so called Norms, though, are only soft law and face resistance from states, making it unlikely that they will be turned into binding international law anytime soon.

C. Current Rights of Transnational Corporations under International Law

Since TNC activities are by their very definition transcending international borders, they are difficult to regulate by national authorities. Not only do states face practical regulatory difficulties, but they also face international legal limitations on the regulation of cross-border activities, which makes TNC activities a key challenge for contemporary international legal theory. In particular, the nationality principle limits the regulatory capabilities of states through the sovereignty of

482 Cf. S. Kirchner, supra (n 2), 228.
484 Cf. S. Kirchner, supra (n 2), 229.
485 L. Catá Backer supra (n 3) 180.
486 Ibid., 101.; skeptical with regard to more general rules also F. Johns, supra (n 14) 899
487 L. Catá Backer, supra (n 8) 5.
489 J. E. Nijman, supra (n 4) 365.
490 T. Morimoto, supra (n 21) 137.
other states which is affected if TNCs operate abroad through daughter companies that are incorporated in the foreign states in which they operate.\textsuperscript{491} Such daughter companies are financially dependent on the mother which is incorporated in the state which seeks to regulate it but are legally independent\textsuperscript{492}, making it virtually impossible for the regulating state to influence them directly.\textsuperscript{493}

Therefore there have been calls for international regulation of TNC activities. It would go far beyond the purposes of this article to go into the details of how international law is used in attempts to regulate TNCs, for example, in the field of international environmental law and workers’ rights. Suffice it to say that TNCs \textit{de lege lata} already are burdened with a number of responsibilities under international law, although too many of them only enjoy the status of soft law, like the aforementioned Norms.

On the other hand, corporations do enjoy \textit{locus standi} in several contexts\textsuperscript{494}, for example as \textit{amici curiae} in the World Trade Organisation’s Dispute Settlement system\textsuperscript{495} since the \textit{Shrimp/Turtle}\textsuperscript{496} and \textit{Lead and Bismuth II}\textsuperscript{497} cases, as parties before the International Tribunal for the Law of the Sea but also as \textit{amici curiae} and/or parties before NAFTA tribunals\textsuperscript{499}, ICSID

\begin{thebibliography}{99}
\bibitem{491} S. Kirchner, \textit{supra} (n2) 221.
\bibitem{492}\textit{Ibid}.
\bibitem{493} T. Morimoto, \textit{supra} (n21) 147.
\bibitem{494} S. Kirchner, \textit{supra} (n 2) 230; K. Ipsen, \textit{Völkerrecht} (5th edn., C.H. Beck, Munich,2004) 110.
\bibitem{495} WTO Dispute Settlement Understanding, Article 13.
\end{thebibliography}
The question whether corporations should be heard in the process of creating new rules of international law is a political question which is not the subject of this paper. The question we have to answer is, assuming the political question is answered in the affirmative, how can such an inclusion be facilitated in terms of international legal theory. In this context, it is important to remember that we are not merely referring to codes of conduct which corporations adhere to voluntarily, i.e. the rules they impose on themselves or soft law rules. Rather, we are explicitly referring to the involvement of TNCs, like it is already the case with NGOs, in the creation of new norms of international law which legally bind both them and others.

D. **Does the lex lata allow for a law-making role for transnational corporations?**

In general, the creation of new rules of international law requires an act by the states, either directly or through intergovernmental international organizations.
(IOs). But as Public International Law evolves, the question that needs to be raised is what would be necessary to elevate TNCs to the status required to participate in the creation of new rules, in particular to an extent which goes beyond the initiating and consultative functions enjoyed by entities such as NGOs. The case for the role of TNCs is best constructed with reference to NGOs, rather than IOs. As a matter of fact, from a technical perspective, TNCs are a type of NGO: TNCs as well as NGOs are active internationally but incorporated domestically; they both aim to transcend borders, yet find themselves limited by them in so far as they enjoy legal personality as juridical persons in national legal orders.

When it comes to the question of whether TNCs should have a greater role in shaping international law, we have to remember that law reflects on the society to which it applies and a major change in the composition of the society in question can have an effect on the rules which govern it. In general, “[a]n entity is a legal subject of Public International Law, if it is legally able to hold rights and obligations and to claim such rights on an international stage.”

While the sovereign equality of states is a key principle of Public International Law, this does not mean that entities which could be considered subjects of Public International Law in a wider sense enjoy the same degree of subjectivity. We can differentiate between full, partial and particular subjects of international law. While the latter are only able to enter relationships with certain other subjects,

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509 Ibid.


511 S. Kirchner, supra (n 4) 86.

512 Charter of the United Nations Art. 2 no. 1.

513 Shaw, supra (n 41) 137.

514 Ibid.
partial subjects are dependent on the power conferred upon them by full subjects as regards the extent to which they can enter into legal relations. 515

This already indicates that the view of other actors on the capabilities of an actor is not without importance. An IO for example can only act on the international stage so far as its constitutive document will allow. This constitutive document, of course, is usually an international treaty concluded by states. To this end, the IO is dependent on the states parties to that treaty. Even if the IO enjoys a legal personality of its own, at the end of the day it is only as capable as the states parties to its constitutive document have allowed it to be.

But it also plays a role in determining whether a potential state actually fulfills the third requirement of statehood (in addition to territory and population), the capability to enter into relations with other states. This capability does not only require an effective government but it also requires that there are other states which are willing to enter into relations with the entity in question. Of course, the statehood of Taiwan will not be put in doubt as long as some states consider Taiwan to be a state and Taiwan therefore is able to enter into relations with them. But the case is already different when one looks at entities which have been hardly recognized by states, such as Abkhazia or South Ossetia which are recognized by only a handful of states (as opposed to Kosova, which is currently recognized by more than 70 states) or the so called Turkish Republic of Northern Cyprus, which is only recognized by Turkey itself, the state which facilitated the creation of the disputed entity. Not only the case of Northern Cyprus but also the case of the four homelands Transkei, Bophutatswana, Venda and Ciskei, which had been granted “independence” 516 by apartheid South Africa show that the collective non-recognition of entities as states by all states except (as is the case with Turkey and South Africa), occasionally, the state which created these entities or only other non-recognized entities (as is the case with the mutual “recognition” of Transnistria and Nagorno-Karabakh) does indeed have consequences for an entity’s ability to enter into international relations. 517 Recognition is not a

515 Hobe and Kimminich, supra (n 31) 66.
516 These customary requirements for statehood have been codified in Art. 1 lit. 1 of the Montevideo Convention on the Rights and Duties of States.
requirement for statehood *per se*, but collective non-recognition takes away an entity’s ability to enter into relations with states, thereby depriving the entity in question of the third element of statehood. In a sense, legal subjectivity therefore has its roots in the ability to play a role in the deliberative process which takes place on the international stage.

But if recognition plays such an important role for states, which are, after all, still the key actors of international law, there is *a maiore ad minus*—no reason why recognition should not play a role for lesser actors, including transnational corporations. In fact, since TNCs do have a legal status also in national law, they are doubly dependent on states: domestically, since they require incorporation and internationally, since they require acceptance as a partner in the process of creating new rules of international law. The relational-argument brought forward here can be applied to all lesser subjects of international law which are in one way or another dependent on full subjects—be they IOs, NGOs or TNCs. They can play a role on the international stage if other, full, subjects of international law allow them to do so. In a sense, it is this “capability to enter into relations with others that is now becoming the key test for the determination as to whether or not an entity is indeed a subject of PIL.”

Contemporary PIL therefore calls for “a fundamentally new type of differentiation: between those subjects which have rights and obligations under international law (subject to the law) and those subjects which are involved in the creation of new law (law makers). This does not mean that the existing differentiations become obsolete, but that we add an additional dimension to it—the differentiation between mere subjects to the law and those subjects which have a chance to actually change the law.”

*De lege lata* the important status of TNCs is not adequately reflected in international law. In particular, the organisational similarities between TNCs and other NGOs call for the inclusion of TNCs in the consultative process of international law-making. Today, NGOs can enjoy consultative status with

518 S. Kirchner, *supra* (n 4)88.
519 *Ibid*.
520 S. Kirchner, *supra* (n2) 231; cf. also M. Reisman, “The View from the New Haven School of International Law” (1992) 86 *ASIL Proceedings* 118, 122.
ECOSOC and can play a role in supervising World Bank projects. From an organizational perspective, there is no reason why TNCs should be not be included when NGOs already are. While it is obvious that TNCs will pursue goals other than, for example what a human rights NGO will pursue, but in the end, both types of organizations pursue goals which are political in the widest sense. Whether the motivation for pursuing the goals in question is mainly commercial or altruistic can vary from case to case and is too vague a criterion so as to allow for a differentiation in the roles of both types of actors.

So far, TNCs play a role in the creation of new rules primarily when they themselves are concerned, that is, in the domain of Private International Law rather than Public International Law. They do not yet play a full role in creating new rules of Public International Law, but they could be engaged more than is currently the case. From the perspective of international legal theory, the question of whether to engage TNCs more in the creative process of making of international law is merely political in nature.

TNCs will have a greater role if they are recognized by other actors to the effect that they ought to be included in the deliberative process which leads to the creation of new norms. As an *argumentum e contrario* from the conclusions drawn on the collective non-recognition of entities as states, I propose that the factual engagement of TNCs by other subjects of international law in the law-making process can constitute a degree of recognition which will elevate TNCs to the same level as other NGOs. As mentioned earlier, some NGOs are already given a consultative status e.g. by the United Nations’ ECOSOC and they can act as *amicus curiae* in international litigation. TNCs are non-governmental forms of organization, but they do not enjoy the reputation enjoyed by classical NGOs as stewards of the public interest. TNCs are essentially seen as serving their own interests (or that of their shareholders). But TNCs also matter to many people, such as employees or customers. While both employees and customers can find themselves in a conflict with TNCs, the factual power of large multinational corporations might make it...
just a matter of time until TNCs might be involved in the creation of more binding norms of Public International Law. Their factual importance practically demands some involvement in order to reach effective results and to increase the likelihood of compliance of TNCs with international legal standards—at the risk of watering down standards. Undoubtedly, getting TNCs involved in making international law will bring risks with it.

E. CONCLUSIONS AND OUTLOOK

The potential development proposed here would be part of the evolution of the law to a post-Westphalian stage, but it would by no means herald the advent of a completely new law. Rather, international law evolves towards a completeness which more adequately addresses the power realities of our time—without cutting off the roots which nourish it.

This becomes particularly visible when we remember the continued importance of the states for the international legal system: While non-state actors, NGOs as well as TNCs, today can play a role in international law, both by asserting rights and by influencing the creation of new rules, the responsibility for enforcing international law still rests squarely on the shoulders of states parties to international documents. This will not change in the foreseeable future. At best, states can delegate this task to international intergovernmental organizations, but even when the latter enjoy full international legal personality, at the end of the day it is the states which found and which fund them that will have to bear the responsibility to ensure that international law is adhered to by all sides, states as well as non-state actors under their jurisdiction.

Certainly, TNC activities can cause serious problems, but any rule of international law is just as good as its enforcement. Enforcement is a key problem of international law and will remain an important challenge for the future. While it is politically more attractive to be seen involved in the creation of new rules of material law, which sends the signal that things are getting done, the enforcement of international law needs further attention, in particular on the part of states. The increasing involvement of non-state actors does not absolve the States of this responsibility which they bear as the key subjects of contemporary international law.

The reason why states have this ultimate responsibility is that they enjoy an unparalleled degree of legitimacy. Undemocratic states still pose a very serious
problem in this respect, but at least states provide a nexus between the general population and the creation of new rules, as thin or fragile as this connecting band may be. NGOs and TNCs, although they do play important roles, lack this direct connection. Often NGOs are perceived as “good” (when dealing with issues of human rights or with environmental concerns) while TNCs tend to be perceived as “bad” (causing environmental pollution and human rights abuses). This general perception is not without reason, but just as it cannot be ignored, it must not lead to the conclusion that political or other goals may influence the right to participate in the deliberative process which will lead to the creation of new rules. The reality of the impact these actors have on our globalized society cannot be ignored. It is due to their practical importance that they need to be heard. Otherwise we would have to deny a voice also to, say, the People’s Republic on China and cut off more than a billion people from the process which shapes international law. Rather than cutting the already existing ties between the population and international decision-making processes which are anyway fragile due to a lack of domestic responsibility, the sovereign equality of nations and the cooperative nature of Public International Law as such demand that those states are engaged by more democratic states with the purpose of drawing them deeper into the deliberative process which leads to the creation of new rules. In the long run, this might also strengthen domestic decision-making cultures by importing stronger deliberative elements, which can put a nation on the track to democracy, just like the Helsinki Final Act helped steer the Warsaw Pact countries towards more freedoms.

In principle, the same benefit of being engaged in deliberative decision-making on an international level applies to non-state actors and in particular, to the compliance with international standards on the part of transnational corporations. TNCs are more likely to adhere to international standards if they have had a say in creating them. Just like with NGOs and states, it has to be clear that TNCs will have their own agendas, nevertheless, this cannot exclude them from having a voice in the creation of new rules. Transnational corporations must be included in the creation of new rules of international law as much as other non-state actors. This might even lead to more acceptance of international law by customers, i.e. with the general population, the lives of which it increasingly regulates - directly or indirectly. Such an inclusion, though, will require the creation of solid democratic standards which do not yet exist at this time. In addition, a more solid constitutionalization
of international law - with a clear focus on human rights - is necessary in order to provide a framework within such an increased participation can happen.

Non-state actors are “derivative subjects” of international law. But at the end of the day, all traditional and new subjects are derivatives from the one original subject of man-made law, the human being. De facto, non-state subjects might be “second-class” subjects when compared to the state, but that does not mean that they do not play a role in making new rules of international law. While “creating rights and obligations left, right and centre, however useful perhaps in itself, does not add up to sort of paradigm shift that international law might need in order to truly accommodate entities other than states”, but these developments indicate that such a change is - while not yet realized - at least possible.

TNCs cannot replace states as the primary makers of international law. While the individual is the core unit of the international society (and families, tribes, nations, municipalities, states, NGOs, religious groups, corporations, international organisations etc. are forms of organisation of multiple individuals on the sub-global level), the state remains the key actor on the international scene. It is, however, no longer the only subject and TNCs should have a role to play as well. This idea is not new: There is little doubt that [Multi-National Enterprises] have been, and continue to be, actively involved in the generation of legal standards applicable to their respective markets and industries. What is new is the idea that this sector-specific role can be extended towards a more general approach. However, as a prerequisite, international law will also have to provide better safeguards which protect common interests such as human rights and the protection of the natural environment against abuses, regardless of the legal nature of the perpetrator.

524 For a “constitutional” approach see also Thurer, supra (n 7), 51.
526 Ibid.
527 Ibid. 368.
528 The idea of international law without states has been explored in detail in G. Teubner (ed.), Global Law without a State (1st edn., Dartmouth, Aldershot / Brookfield / Singapore / Sidney, 1997).
530 Ibid. 86.
Debunking ‘Choices’ in International Trade: Contextualising National Treatment through the Tort Law Paradigm

By
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ABSTRACT

One of the basic assumptions that tort law theorists make, is that the law always takes a decision that is prone towards achieving both efficiency as well as the overall reduction in social costs. Given such an assumption, the issue, however which has been the topic of long lasting argumentative discourse, is the constant dilemma which legal institutions face, with regards to whether it is the ‘rights based’ formulation/interpretation/application of the law that must prevail or whether the maximization of economic welfare/efficiency should be the larger paradigm for a proposed legal system. In addition to drawing and examining such a distinction in international trade law, through the eyes of the torts model, this paper reviews an alternate line of reasoning propounded by Mark A. Geistfeld, (a faculty member of the International Law Department at the New York University School of Law), through his contribution in Theoretical Foundations of Law and Economics (Cambridge University Press, 2010). Through his model of analysis, Geistfeld reflects upon the possibilities of the co-existence of both approaches, namely those of being ‘rights based’ as well as ‘allocatively efficient’, thereby paving way for an overall clarity of ‘choice’ in the legal system.

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The central hypothesis of the above-mentioned analysis model is to prove how the system of tort law that he proposes has the potential required to fulfill the conditions of being fair, while significantly reducing the social costs of accidents. The primary purpose of the author therefore, shall be to debunk falsities of nomenclature related to the National Treatment Principle in international trade law in the WTO regime, in a bid to show how the problem of choice continues to plague policy processes, and which can be countered through the balance of such ‘choices’ in trade. Such questions shall be addressed with special reference to Prof. Upendra Baxi’s ‘third worldism’ paradigm, in the context of developing and underdeveloped countries and the role played by normative and existential contradictions therein. Given the nature of several artificial trade barriers which exist today, which are antithetical to the primary intent of the New Economic Order, the larger objective of the author’s research is to bring about the constant dichotomy that prevails in the trading realities of the globalizing world, in the garb of public policy and the legitimate ‘choice’ that evidently works to the detriment of a unified economic system.

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1.0 TOWARDS LEX FERENDA: EXPLORING THE DIFFICULTIES OF ‘CHOICE’ IN LAW AND POLICY

The last quarter century has been witness to a sporadic rise in scholarly literature, dealing specifically with the increase in the policy analysis of the international economic and tort law systems.\(^{532}\) One of the primary reasons as to why such theoretical perspectives have become crucial to a contemporary understanding of the international paradigm of economic law\(^{533}\) is the fascinating manner in which a policy analysis of ‘law’ in its relations with policy is undertaken, in order to provide a platform for suggesting additional models of academic interpretation.\(^{534}\)

Unlike several other areas of legal interpretation, the policy analysis of international economic law, more often than not, tries to look at law as an efficient yet existent domain\(^{535}\) of international trade relations, rather than trying to define what the law should be.\(^{536}\) (similar to the distinction drawn between lex lata and lex ferenda by Akehurst)\(^{536}\) In fact, one of the basic assumptions that tort law theorists make, is

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\(^{534}\) Ibid.


that the law always takes a decision that is prone towards achieving both efficiency as well as the overall reduction in social costs.537

Given such an assumption, the issue, however, which has been the topic of long lasting argumentative discourse, is the constant dilemma which legal institutions face, with regards to whether it is the ‘rights based’ formulation/interpretation/application of the law that must prevail538 or whether the maximization of economic welfare/efficiency should be the larger paradigm for a proposed legal system.539 In addition to drawing and examining such a distinction in international trade law, through the eyes of the torts model, this paper reviews an alternate line of reasoning propounded by Mark. A Geistfeld, (a faculty member of the International Law Department at the New York University School of Law), through his contribution in *Theoretical Foundations of Law and Economics* (Cambridge University Press, 2010).540 Through his model of analysis, Geistfeld reflects upon the possibilities of the co-existence of both approaches, namely those of being ‘rights based’ as well as ‘allocatively efficient’, thereby paving way for an overall clarity of ‘choice’ in the legal system.

The central hypothesis of the above-mentioned analysis model is to prove how the system of tort law that be proposes has the potential required to fulfill the conditions of being fair, while significantly reducing the social costs of accidents.541 Therefore, at the level of policy making, alternate deconstruction provides for a new model of analysis, by working out the most plausible of the existent models of analysis which have been the issue of extensive discourse in the past.

The primary purpose of the author, therefore, shall be to debunk falsities of nomenclature related to the National Treatment Principle in international trade law.

538 Ibid.
540 This particular piece of theory/analysis has been found in the paper titled ‘Efficiency, Fairness and the Economic Analysis of Tort Law’, authored by Mark Geistfeld in the book titled *Theoretical Foundations of Law and Economics*, (Cambridge University Press, 2010).
541 Geistfeld proposes a line of reasoning that is rather different from existent tort law scholarship, which has been dealt with in detail in the later section of the paper.
law in the WTO regime, in a bid to show how the problem of choice continues to plague policy processes, and which can be countered through the balance of such ‘choices’ in trade. Such questions shall be addressed with special reference to Prof. Upendra Baxi’s ‘third worldism’ paradigm, in the context of developing and underdeveloped countries and the role played by normative and existential contradictions therein. The reason as to why Baxi’s theoretical propositions are of importance to us is to enhance our understanding of the practical shortcomings of the current ‘global’ trade regime. Given the nature of several artificial trade barriers that exist today, which are antithetical to the primary intent of the New Economic Order, the larger objective of the author’s research is to bring about the constant dichotomy that prevails in the trading realities of the globalizing world, in the garb of public policy and the legitimate ‘choice’ that evidently works to the detriment of a unified economic system.

2.0 EXAMINING POSNER’S ALLOCATIVE EFFICIENCY MODEL: IS THERE A NEED TO NORMATIVELY JUSTIFY THE OPERATION OF ‘LAW’?

Richard Posner, through his paper titled ‘The Economics of Justice’, propounds how the system of tort law should essentially aim at the maximization of wealth through the minimization of accident costs.542 The basis on which Posner advances such a line of argument flows from the idea of legal entitlements (in terms of what the law should or should not define as right or wrong, and what liberties are to be granted by the State) not requiring a normative justification, and that legal provisions should be looked at in isolation, through an economically ‘efficient’ model. Geistfeld rejects this line of thinking at the very beginning of his paper, where he vehemently opposes Posner, stating that ‘the substantive content of any legal rule depends on the normative justification and not economic analysis’.543 Interestingly, while the contemporary theoretical foundation of such a proposition was laid down by Posner, Kaplow and Shavell further embarked upon the idea of the mutual exclusivity of fairness and wealth maximization,544 by contending


543 Ibid.
differently, that a ‘fair’ system of tort law would stand as Pareto inefficient, and should therefore not be adopted.545

Reflecting upon the pool of opposition that such ideas faced in the aftermath of this proposed model,546 the most potent, as Geistfeld rightly points out, was that of corrective justice.547 Scholars critiquing the Kaplow Shavell model argue that achieving economic efficiency and the maximization of wealth is only a secondary concern548 as far as legal formulation is concerned.549 What is to be the topmost priority of lawmakers is the statutory recognition of a certain legal obligation and the consequences of disobedience to the same.550 The natural inference (although not explicitly expressed) of such a line of reasoning, is that a modification in the rationale of tort liability in favour of making it one that recognizes individual rights, should be given larger preference in relation to one that favors welfare maximization.

Within the larger paradigm of international economic law and cross border party transactions, lies the question of ‘choice’, which seems to have occupied a more pivotal role to policy processes in the trying times of economic slowdown. The National Treatment Principle, vital to most trade and treaty regimes, includes the similar treatment (through rights and benefits) of both local as well as foreign goods within the market. As was observed in the Japan Taxes case, as well as in ECAsbestos, the principle of law envisaged in the National Treatment Principle is structurally similar to that of the tort law paradigm. Making the ‘allocatively efficient’ choice in terms of what is best suited to the needs of a recessionary economy, may often fall within statutory exceptions, but often becomes a problematic choice even when economic slowdown is not observed. For instance, if one notices the manner in which American or British policy decisions are taken at an international level, especially in the backdrop of the likes of internationally

546 Geistfeld (n 10).
547 Geistfeld (n 10).
548 Geistfeld (n 10).
550 Murphy (n 9).
imposed obligations such as the Kyoto Protocol, it becomes fairly pertinent that irrespective of the current economic condition in the country, reservations to the GATT or the GATS regime work as detriments to that which the international law regime seeks to achieve in facilitating cross border transactions and the prevention of discrimination based either on origin or otherwise.

3.0 FROM JAPAN-TAXES TO CHILE-TAXES: WHY THE POLICY OPERATION OF ARTICLE 3 OF THE GATT LEADS TO ‘SERIOUS PREJUDICE’ TO THE NATIONAL TREATMENT OBJECTIVE

We begin by examining the second paragraph of Article III of the GATT. Paragraph 2 states:

The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

The second sentence of this particular article also has an interpretative note which reads as:

A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.  

If one notices the wording in Article 3.2, one may infer that a party alleging a violation of this particular clause may have two routes to argument. First, to contend that the domestic and the foreign products are ‘like’ and that the degree of taxation, in terms of what the consumer has to pay for them, incident upon the latter is greater in magnitude than that on the former and secondly, that the two

551 Supra n. at 2
products in question are directly competitive and also not similarly taxed and that the purpose of this dissimilar taxation is the protection of the domestic industry of that particular country.

To understand the situation analogously to previously decided cases, three cases are of particular importance to us. In the *Japan-Taxes on Alcoholic Beverages* case,\(^{552}\) the locally produced Japanese alcohol ‘sochu’ received the benefits of a Japanese tax law which made customers liable to pay a lesser sum as taxes on it than certain Western alcoholic beverages imported into Japan. While it was an established fact that ‘sochu’ was in fact a ‘like product’ to those originating in the Western countries, the question of de facto discrimination remained. Similarly, in the *Korea-Taxes on Alcoholic Beverages* case,\(^{553}\) the beverage in question was the diluted ‘soju’. Now, it is interesting to note that the beverages imported were of a distilled nature, not a diluted nature. It was on the basis of this particular difference that Korea argued that these were not ‘like products’, neither were they DCS (Directly Competitive or Substitutable). Similarly, in the case of *Chile-Taxes on Alcoholic Beverages*,\(^{554}\) the product in question was the ‘pisco’ which again was not taxed to the extent of the imported products. In all three cases, it was found that such policy measures were in contravention of Article 3.2, on grounds of de facto discrimination, that is not explicitly based on origin.\(^{555}\) The 1992 *Malt Beverages* report, laid down the fact that a ‘like’ product is determined by how consumers would respond to a particular product.\(^{556}\) However, it is not quite as simple as this. In the 1994 *Gas Guzzler Report*, the test of ‘likeness’ was not in terms of prevailing market perceptions, but on the basis of the ‘aims and effects’ test.\(^{557}\) The reason why this particular report is of immense importance to us is because this also happens to be the last case decided in the context of Article III in the

\(^{552}\) Korea- Taxes on Alcoholic Beverages, WTO Dispute DS75.

\(^{553}\) Chile- Taxes on Alcoholic Beverages, WTO Dispute DS87.


\(^{555}\) United States - Measures Affecting Alcoholic And Malt Beverages, WTO Dispute DS23.

GATT era. As per the ‘aims and effects’ test, the particular policy measure was seen to have the ‘aim’ of providing protection when an analysis of the circumstances provided that the protection was indeed a desired outcome and not merely a co-incidence. In the Korea-Taxes on Alcoholic Beverages case, a further clarification regarding ‘like’ and DCS products was made. The report went on to say that directly competitive products are those who have a common end use. It would be extremely interesting for us to note, that in the abovementioned cases, an ‘exceptional’ situation was not contended. In all three cases, parties pursued independent policy objectives as economic measures and were not specifically designed to combat a societal threat.

What we may therefore see, is that through the operation of policy tests such as the ‘aims and effects test’ or the ‘likeness’ test, serious prejudice is often caused by domestic trade and tax policies, to trade from beyond national territory. As one can well imagine, it becomes increasingly difficult to exactly determine what the real aim of a particular policy measure is, even when understood within context unless and until the legal structure itself provides for a mechanism whereby offenders are automatically recognized. A similar problem prevails while trying to unearth the ‘likeness’ of two products, especially considering the nature of several protectionist regimes across the globe. Evidently, this cannot be done. It is submitted that through the operation of such policy assessment measures, whether customary in the international legal system or not, the policy process sees the allocation of choice based on the real needs of the economy. Consequently, countries, instead of downright belittling/dismissing the spirit of the National Treatment Principle, focus of justifying discriminatory domestic policies within the domain of international legal provisions.

Clearly, the ‘choice’ making debate is highly misconceived, but we shall continue to examine if policy mid points do exist in international economic law, for the purposes of global trade and commerce.

While on one hand, one may contend that exceptional situations as contemplated by such countries and as effected through reservations in international treaties and agreements ensure that the allocation of ‘choice’ is efficient, can we dismiss the contention that the normative justification of the international economic system in cross border trade treatment is pivotal to the existence of the National Treatment
Principle as a treaty and as a customary norm under international law? Let us explore the question in the following section of this paper.

**4.0 THE NEED FOR ‘RELATIVE INTERPERSONAL PRIORITY’ IN THE BALANCING OF INTERNATIONAL TRADE INTERESTS**

A rights-based model of tort law arises out of the constant conflict of interests that are created by societal elements, which often result in physical damage to one, or even both parties. If one considers the example of driving speed limits that the law imposes, the driver of large vehicles is mandated by the law to drive within a legally specified limit, which stands as a limit to his or her liberty, in the sense that the reckless exercise of choice is not legally permissible. On the other hand, adopting the viewpoint of the pedestrian who is likely to be physically as well as mentally injured as a result of the driver breaking the law, jaywalking (acts of recklessly crossing roads etc) is also forbidden. What may therefore be observed is that legislations such as the Uniform Vehicle Code (1992), in the United States of America, significantly reduce the available exercise of liberty to the pedestrian as well. The point where the law steps in is to mediate such conflict of interests. Now, the ideological difference between the two approaches is simply this: that a tort law principle which is designed to be ‘fair’ prioritizes the physical security of the pedestrian over the liberty of driving at any speed, (something that the author calls a greater ‘relative interpersonal priority’) not necessarily taking into concern the resultant wealth maximization. A compensatory tort right therefore stems from the burden that the law imposes on the subordinate liberty interest of the driver; an obligation to put the physical interests of the pedestrian before his or her own. An important distinction however, is that the nature of this priority is not absolute.

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559 Ibid.
561 Geistfeld (n 10).
563 Geistfeld (n 10).
As Geistfeld mentions, in the context of legal precedent, ‘most of the rights of property, as well as of person, are not absolute but relative’. Let us be reminded that the importance of defining the nature of such priority of physical interest over the driver’s liberty is that a degree of relativity allows for the possibility of a tradeoff of the conflicting interests and in the determination of liability. In the context of economic law, the question to ponder is the possibility about such a methodology of enquiry. Within the international economic domain, even if we were to assume the preambulatory nature of the chapeau to be inspirational and per se non binding for the global trading community, is there a remote possibility that the subordination of first world trading interests within the commercial sphere can transform into reality?

5.0 **Upendra Baxi and ‘Third Worldism’: Giving the ‘Microscopic Minorities’ a Reinvented Place in International Trade Discourse**

As Prof. Upendra Baxi suggests, there is need for ‘third worldism’. This particular form of ideological resistance to the hegemonic structures of the original actors in international law is also becoming increasingly relevant to the reformulation of occupying places in trade discourse, and the representation of interests of the developing and under-developed nations. The interests of these nations, for whom a major part of the GATT and the GATS regime is actually constructed, must be taken into account while implementing policy, so that the operation of tests such as the ‘aims and effects test’ or the ‘likeness/DCS’ test’, do not work as mere lip service to the National Treatment Principle. As Baxi posits, the emergence of third worldism as an ideology that seeks to reformulate the boundaries and re-establish the extent of third world participation in international law, and international trade law specifically, is important to ensure that the ‘microscopic minorities’ (third world countries in international trade law discourse) are increasingly benefitted by the new world trade regime, in terms of reducing barriers to cross border trade. A fundamental basis of Baxi’s academic proposition is the predefined role of the third world within international law discourse, and the current need to resist such processes of hegemonic generalization, through what he calls ‘third worldism’. Within his ideas of compossibility also lies the inherent

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need to relook the operation of global trade and questions of construction and validation of first world trade policy which cannot be divorced from the ‘fractured constellation of the non European community’. While on one hand, it is sufficiently established that the basis of trade principles such as National Treatment, flow from an international belief of the need to reduce cross border trade discrimination, we must appreciate the fact that the overbearing nature of increased global trade leads to what Baxi calls ‘subaltern cosmopolitanism’, in terms of the third world being cornered by first world practices.

It is submitted that this ideology functions through doctrinal conceptions of the National Treatment Principle, and whose functioning is necessary for developing and underdeveloped countries to be provided a platform for increasing cross border trade volumes, and an opportunity at better rates of growth. It is in fact inherently discriminatory to allow for reservations or domestic policies which prevent the realization of such economic goals, within the statutory legitimacy of the GATT and the GATS regime. From what we have previously widely observed, the operation of the ‘aims and effects test’ or the ‘likeness test’ have worked to defeat the object and the purpose of the GATT and GATS regime, in addition to reservations and disobedience of customary international law.

Speaking in the context of the torts model, the sharp distinction between the two approaches is also well observed by the weightage that each of them gives to this ‘relative priority’. From a purely economic standpoint, the conventional analysis will take the initial entitlement of the pedestrian into consideration only for the purpose of defining the right of the pedestrian, in terms of availability of a legal remedy. It does not give any further weightage to any pre decided notion of what a moral standard should or should not be. Instead, stemming from the fact that this model revolves around cost benefit analysis, it then goes on to include other elements of costs, such as the cost of injury, precautions, administrative costs, and others. If after the summation of all such costs, the burden of physical security stands to be greater than the social costs of accidents, then the pedestrian’s interest may be compensated.

567 Pigou, The Economics of Welfare (1932).
Vehemently opposing such line of reasoning, theorists of the rights based school criticize the apparent insensitivity\(^{569}\) in the stand that the welfare school of thought takes, in giving much greater relative weightage to social expediency\(^{570}\) over morally sound individual interests/duties/obligations.\(^{571}\) In fact, their stance in the present matter is appropriately summed up when Perry says ‘the main reason that personal injury constitutes harm is that it interferes with personal autonomy’.\(^{572}\)

### 6.0 Explaining Kaplow And Shavell Through Law, Morality And Pareto Inefficiency

The model proposed by Kaplow and Shavell on the other hand, is one which deals with redistribution of savings from the benefits of wealth maximization. As per the theory propounded by them, the trade off that takes place between fairness and economic welfare, while formulating the desired system of tort law, leads to a Pareto inefficient situation. This happens because as the concern for fairness of a tort law provision is given more and more weightage, some positive component of welfare is constantly sacrificed. They further contend that if the society were to adopt such a rule instead of one that is rights based, then it would be viable and perhaps, more profitable if the savings from the welfare approach could be redistributed free of cost to all the members of the society. A basic assumption to this theory is a case where individual differences are taken into consideration.\(^{573}\) For instance, the welfare that is gained by moving from State ‘f’ (fair) to welfare State ‘w’ may not be the same for all individuals, thereby leading to a situation where this move to State ‘w’ is not necessarily Pareto efficient.

However, the question on efficiency is answered by the construction of a completely new State entity, State ‘r’, where the total welfare remains the same as that in State ‘w’, and the welfare that is gained from the movement to this particular state, from State ‘f’, is further redistributed amongst all the members of the society,

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569 Ibid.
570 White (n 40).
landing nobody in a ‘worse-off’ position. As a result of this, preference of State ‘r’, over ‘f’ is only rational decision making and a violation of the same would lead to a Pareto inefficient situation.574

One could possibly contend, that within the domain of international trade law, a constructive advantage arising out of the successful operation of the National Treatment principle, works in a similar manner as defined in the Kaplow Shavell model. Through increasing volumes of global trade and the generally higher productivity levels of the global trade market, cross border competitive disadvantages are likely to be much lower, alongside the successful benefits from international trade in rare and specialized commodities, many of which can be produced exclusively in developing and under developed countries. Howard Chang offers a radically different rebuttal to their models of analysis by arguing that fairness was to be given separate weightage with respect to welfare, and could therefore not be taken into consideration at all in case the legal rule that was being formulated would increase the welfare of all individuals in the society.575 The concluding analysis of his model propounds the idea of this variable weightage not being Pareto inefficient.576 Refuting such a theoretical proposition, Geistfeld is opposed to the idea that absolutely no unfair rule would be problematic as long as it reduced certain ‘administrative cost savings, share per capita’. He further goes on to say that ‘any theory that allows the fairness concern to become infinitesimally small under these conditions does not seem to be worth taking seriously’. Moreover, society would be witness to the growing occurrence of anarchy,577 as nothing would essentially remain a duty at all, considering the little weightage that was to be assigned to certain moral standards of rights and obligations. As Richard Wright aptly points out, ‘the aggregate risk utility test,

which gives equal weight to security and liberty interests, cannot be reconciled with the principles of justice'.

In the context of the international economic law paradigm, preference to the ‘relative interpersonal priority’ or to the Pareto efficient system (read: increasing volumes of global trade proportionally or less than that of domestic economic gains) may well involve questions of national policy, and may defer from one context to the other. The point however, is that irrespective of reservations to a treaty norm, if the manner in which the National Treatment works on a country specific basis, defeats the very essence of the international trade regime, then we must look for a balance between the two choices. One may make an academic but unpragmatic argument to say that perfect equilibrium of choice and resources may be reached in global trade and policy.

What we must therefore appreciate through the torts model, is that ‘reduction of social costs’ as witnessed by civil disputes, refers to the failure of the international legal paradigm if State policies, even during economic boom, curtail the operation of the National Treatment Policy. One must remember the propositions of Rosalyn Higgins as juxtaposed by Goldsmith and Posner when the debate over the construction of legal formulation as a means to achieve normative policy objectives ensues. The detailed examination of the theoretical propositions of the abovementioned scholar seems to suggest that the ultimate objective of law was to ensure that its integrated relationship with policy, by being the ‘rational actor’, is not disturbed so as to ensure the normative legitimacy of the system. How far such a proposition is even imaginable within the economic law domain is highly questionable. Therefore, for purposes of this paper, it is submitted that (a) the operation of the international legal system cannot be divorced from the policy objectives it seeks to achieve and (b) Goldsmith and Posner’s rational actor theory stating the inability of States to act beyond their own realist objectives is not a misconceived debate and has well been established as customary State behavior.

7.0 Geistfeld and the Pragmatism of Co-Existence: Reaching Settled Shores?

Now, having established what is essential to Geistfeld’s central model of analysis, let us look at how he proposes to execute a balance of both the rights based as well as the allocation based system of tort law. He begins by stating (in the context of the driver-pedestrian example) that ‘the driver must purchase the right to expose the pedestrian to the risk of physical injury’. In the very same example, which surprisingly is the backbone of his proposed model, Geistfeld considers the possibility of the pedestrian being killed as a result of the accident to be a hundred percent. Considering ‘B’ to be the cost/burden of the driver in avoiding the accident, the monetary cost of the risk is to be determined by the willingness of the pedestrian to face the risk of physical injury. Geistfeld further contends that it is this amount that the pedestrian is willing to accept for the risk that makes him or her indifferent between facing the risk and not being compensated and facing the risk and being compensated. Further, the amount of compensation that the pedestrian is willing to accept is the monetary benefit that compensates in exact amounts for the loss in welfare for the pedestrian.

Now, the assumption being made is pivotal to the practical application of this model. Geistfeld says that the efficient level of precaution (not the one set by the law for this particular example) is the summation of the costs of precaution and the initial compensatory payment to the pedestrian for facing the risk (‘WTA’, as he puts it). The allocation of resources would be considered efficient if the precaution costs are less than the compensatory payment or WTA. Further, the pedestrian has been adequately compensated before the risk actually materializes, thereby leading to a situation where the driver is absolved of any liability. Geistfeld concludes by saying that ‘the agreement is allocatively efficient and satisfies the Pareto principle’.

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579 Geistfeld (n 10) 21.
8.0 Rejecting Geistfeld: Over-Simplifying The Problem Of ‘Choice’ In Law-Making

Geistfeld’s attempts at ‘establishing the existence of a class of plausible, rights based tort rules that do not violate the Pareto principle’ are commendable, but not analytically sound. It is imperative to point out at this juncture, that existent tort law scholarship deals with an array of models under the broad theme of reforming the current tort law regime. A significant part of this continuing debate is the balancing, rather, the mediation of the conflict of interests between a rights based and an allocatively efficient tort law system. In fact, the problem of choice, that policymakers keep facing, is an extremely difficult one, loaded heavily with problems of practicality. Geistfeld looks the problem of fairness and efficiency completely in isolation from whether or not such theoretical propositions can be transformed into practice.

‘The fairness enquiry, therefore, must formulate the negligence rule in a manner that gives equal consideration to the welfare levels of the right holder and duty holder, an inquiry requiring economic analysis’.

At the very first instance, where Geistfeld develops his model of analysis, he makes very clear boundaries between the driver of a vehicle, and the pedestrian whose interests in physical security are likely to be harmed as a result of the former over speeding and breaking the standards set by the law. It is in fact this assumption he makes between who the injurer is and who the victim is that may not be a practical reality. One of the fundamental reasons as to why tort law largely remains uncodified, through a uniform legislation, is because of the difficulty in assigning the legally defined roles of injurer and victim to those involved in an accident. Laws such as the Motor Accidents Compensation Act of 1999 in Australia, or the Accident Compensation Act of 2001 in New Zealand do contain a definition clause, but neither of the above-mentioned legislations defines who an injurer is or who a victim is. Further, Geistfeld contends that the potential injurer (which in his thesis is the driver) may exercise the option of compensating the possible

580 Geistfeld (n 10) 26.
581 Geistfeld (n 10) 42.
victim beforehand, and may thereby absolve himself of liability when the injury
does take place, when he says that ‘the pedestrian is fully compensated before she
has been exposed to the risk, absolving the driver to pay any compensatory damages
in the event of injury’. While this particular proposition may be theoretically
possible, its only real purpose is to show the economics of decision making.
Geistfeld fails to drive the contention home by failing to provide for a practical
model of the same. It would be more than unrealistically optimistic to expect a
possible victim to accept such compensatory damages, and then actually stay
indifferent to the mental and possibly permanently physical damages that an
accident might entail. The relative numbers which have been used by the author
to deduce the reduction in the willingness to accept early compensation is not
something that can occur in reality. Moreover, Geistfeld does not consider the
possibility of a situation where death (although even predicting this is problematic)
is the most likely cause of the accident. In such cases, are we to assume that the
potential victim would be indifferent between receiving this compensation and
voluntarily facing the risk of death and not receiving the compensation at all?
Further, are we to agree that there actually exists a possibility of communication
in such cases?

Geistfeld further fails to take into account the fact that more often than not; the
‘victims’ end up taking more precaution than the one which is efficient, and
prescribed by the law. Having taken this into consideration, the co-existence of
welfare as well as rights is not something that can be explained with the help of
one simple example. Also, there is an inherent dichotomy within the model of
precaution that has been proposed for the driver, by Geistfeld. While on one
hand, he contends that a driver can maximize his wealth by associating the cost of
precaution with the compensatory payment (he says that if the cost of precaution
can be made less than the initial compensatory payments, then efficiency is achieved),
he alters his line of reasoning in the case of the death penalty. It is in the case of
fatal accidents that Geistfeld contends that since the possibility of damages after
the death is not possible, the same amount should be invested in the form of
greater precaution. At the level of principle, this is an excellent proposition. The
problem however, continues to be one of translating principle into practical reality.
The question here is, how can the driver remotely predict which accident would

582 Geistfeld (n 10) 23.
lead to death before it even takes place? Clearly, the balancing of priorities, as explained by Geistfeld, works with several unrealistic assumptions, in a similar manner in which the realist operation of National Treatment is likely to work within the contemporary recessionary period worldwide.

9.0 **China-Audiovisuals and Specific Commitments: The Remote Possibility of an ‘Effective Equality of Opportunities’**

In order to reach a viable conclusion, let us employ the methodology of analysis adopted in the *China—Publications and Audiovisuals* case. The primary allegation in this particular case was brought by the United States of America against China in relation to certain theatrical films and audiovisual products (such as DVDs) to be sold within the territory of China. However, the Chinese government in this case acted in a manner that went against certain specific commitments it undertook in its Schedule of Specific Commitments. The competitive opportunities given to the American products were held to be ‘less favorable’. As per this case, two elements had to be examined in order to determine whether or not a violation has taken place. First, the extent of the specific commitments and limitations in the Schedule of Specific Commitments, and secondly, whether or not the treatment given was ‘less favorable’. In the two well-known GATT panel reports – *US—Section 337* and *Italian Agricultural Machinery*, the meaning of the term ‘no less favorable treatment’ (as contained in Article XVII of the GATS as well as in Article III (4) of the GATT) has been explained to mean an ‘effective equality of opportunities’. Another question asked in the same report was whether or not a policy measure directly resulted in limiting the influence of a Foreign Service supplier within the domestic territory of another contracting party. It is submitted that the ‘effective equality of opportunities’ as explained at length in the abovementioned reports, works as mere lip service to the actual operation of the National Treatment Principle. Through the current flexibility of commitments mandated within the statutory framework of the GATT and the GATS, and the

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584 WTO Panel Reports, paras 5, 11 for *US—Section 337* and para 12 for *Italian Agricultural Machinery*.
operation of the ‘aims and effects’ test or the ‘likeness/DCS’ test or even the ‘favorability’ test, National Treatment as a normatively justified trade premise to increase participation from developing and underdeveloped nations faces existential questions, especially during economic slowdown. It is submitted that although reservations or limited specific commitments are indeed an integral part of the statutory scheme of the GATT and the GATS, the progress realization of the National Treatment paradigm must not be compromised in a manner that defeats its very essence.

10.0 CONCLUDING REMARKS

The author, through this particular research initiative, has primarily worked to bring about the finer logistical impediments to international legal policy goals, which continue to remain the greatest hindrance to the effective realization of international law principles. As has been demonstrated in the substantive sections of this paper, the element of ‘choice’ in international economics has worked to the detriment of the attainment of a truly ‘global’ trading village in international economic systems. Therefore, the only plausible solution to the increasingly legitimate ‘choices’ in international hegemonic structures, is the advent of collective response, through third worldism and the questioning of the very basics of efficient ‘choices’ in international law.
Can the West Justify its Sanctions against Russia under the World Trade Law?

By
Rishika Lekhadia *

ABSTRACT

The United States as well as several European Nation’s government in March 2014 declared that the actions and policies of deploying the military forces in Crimea by the Government of the Russian Federation with respect to Ukraine’s internal dispute undermined the democracy in Ukraine. They concluded that this constituted an unusual and extraordinary threat to the national security and foreign policy by the United States, European Union as well as several other nations. Thereafter, these nations imposed several trade restrictions with Russia. Russia challenged the trade restrictions on the ground that it violated principles of GATT. If Russia challenges these trade restrictions in front of the WTO appellate body then it would mount the first formal challenge to trade sanctions in the global trade body. The main defence that shall be taken by the United States and the European Union shall be the security exception under Article XXI of the General Agreement on Tariffs and Trade which gives the WTO’s 159 members the right to take actions that might otherwise violate the body’s rules in the event of an “emergency in international relations”. This paper shall critically analyse the jurisprudence of Article XXI of GAAT to determine whether the sanction imposing nations could validly argue the Security Exceptions to justify their trade sanctions against Russia.

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I. INTRODUCTION

On March 16, 2014, the United States government declared that the actions
and policies of the Government of the Russian Federation with respect to
Ukraine, including the recent deployment of Russian Federation military
forces in the Crimea region of Ukraine, undermine the democratic processes
and institutions in Ukraine. They also threaten its peace, security, stability,
sovereignty, and territorial integrity, in addition to contributing to the
misappropriation of its assets. This was considered to be an unusual and
extraordinary threat to the national security and foreign policy of the United
States. The European Union has also taken a similar position on this issue.
Thereafter, the United States government and the European Union imposed
several restrictions on the financial dealings with prominent Russian
businesses as well as restrictions on trade with the Russian companies.585

Russia has challenged the trade restrictions on the ground that they violate
principles of the General Agreement on Tariffs and Trade (“GATT”). The

585 West Sanctions, ‘Follow the roubles’ (The Economist 2014) <http://
www.economist.com/news/briefing/21599409-how-america-and-europe-hope-put-
pressure-russia-follow-roubles> accessed 01 March 2015.
only possible line of defence that the sanction imposing nations can take is to rely on the security exception under Article XXI\textsuperscript{586} of the GATT. This paper shall critically analyse the jurisprudence of Article XXI of the GATT to determine whether the United States and the European Union could validly argue the security exceptions to justify their trade sanctions against Russia.

The paper has been divided into four main parts. The first part shall briefly discuss the geopolitical conflicts between Russia and Ukraine and how the same has an impact on international peace and security. The second part shall discuss the trade sanctions that have been imposed by the United States and the European Union. The third part shall study the existing jurisprudence under Article XXI of the GATT. The final part shall critically analyse the existing jurisprudence to determine whether the security exception can be successfully pleaded by the United States and European Union were this to come before the World Trade Organisation’s dispute settlement gateway and the possible arguments that Russia could raise against the invocation of Article XXI by the United States and European Union.

\textsuperscript{586} Article XXI of the General Agreement on Tariff and Trade states that nothing in this Agreement shall be construed

(a) to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or

(b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests (i) relating to fissionable materials or the materials from which they are derived; (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment; (iii) taken in time of war or other emergency in international relations; or

(c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.
II. GEO-POLITICAL CONFLICTS BETWEEN RUSSIA AND UKRAINE

Ukraine has been in economic and political crises since early 2000. In November 2013, Mr. Yanukovych, the then President of Ukraine who was an ardent supporter of Russia, decided to abandon the free trade negotiations with the European Union for easy money and political asylum from Russia.587 This action of the President infuriated thousands of Ukrainians who saw it as a further blow to their economy and thereafter started the ‘EuroMaidan’ protests.588

The protests turned violent and the violence escalated when the Government machinery dealt with the situation by attacking the protestors.589 The interactions between the Government and the protestors were closely observed by other nations, and the foreign ministers of Germany, Poland and France decided to mediate the same.590 This round of negotiations resulted in Ukraine adopting the Constitution that it followed prior to 2004.591 However, the protestors wanted the President to step down by the end of February 2014.592 Amidst the protests, Ukraine’s President Mr. Yanukovych took political asylum in Russia. Thereafter, Ukraine was taken over by an ad-hoc government formed by the protestors.593

588 ibid.
589 ibid.
590 ibid.
591 The Orange Revolution was a series of protests and political events that took place in Ukraine from late November 2004 to January 2005, in the immediate aftermath of the run-off vote of the 2004 Ukrainian presidential election which was claimed to be marred by massive corruption, voter intimidation and direct electoral fraud. Kiev, the Ukrainian capital, was the focal point of the movement’s campaign of civil resistance, with thousands of protesters demonstrating daily.
592 Cf Kharkiv (n3).
593 Ibid.
Historically, one of Ukraine's eastern territories, Crimea had been a part of Russia until 1954. Thereafter, it was transferred to the Soviet Republic of Ukraine by Nikita Khrushchev. Furthermore, Crimea’s largest city Sevastopol is largely populated by Russian speakers. Amidst the protests in Ukraine, on February 23, 2014, around twenty thousand people in Sevastopol, the capital city of Crimea, overthrew their mayor who had been appointed by the Central Government and instead appointed a Russian citizen in his place. In response, Russia deployed 150,000 soldiers to Crimea which resulted in a large scale massacre. On March 6, 2014, Crimea’s Parliament voted to join Russia. Thereafter, based on the result of a referendum that was held in a predominantly Russian region in Crimea, it declared independence and formally applied to join Russia on March 17, 2014. Mr. Putin announced in the Russian Parliament that Crimea, that had been taken over by the pro-Russian forces, has historically been a part of Russia. He then moved for an amendment of the Russian Constitution to include Crimea within its territory which was opposed by the majority of the countries across the globe as they declared the referendum to be illegal under international law. The United States called a G7 crisis meeting to respond to the crisis in Crimea. French President Mr. François Hollande


595 Ibid.

596 The Economist explains, ‘What the original Crimean war was all about’ (The Economist 2014) <http://www.economist.com/blogs/economist-explains/2014/03/economist-explains-5> accessed 01 March 2015.

597 Ibid.


599 Ibid.

600 Ibid.

601 Ibid.
also urged the European community to give “strong and coordinated European response” to the Russia’s rampant violation of the principles of international law.622

On the other hand, Mr Putin appeared before crowds in Moscow’s Red Square and declared that Crimea shall become part of Russia again.603 Thereafter, amidst all the international uproar, Mr. Putin, Crimea’s Prime Minister Mr. Sergei Aksyonov, the region’s Speaker Mr. Vladimir Konstantinov and mayor of Sebastopol, Mr. Alexei Chaliy, signed the treaty making Crimea a part of Russia.604 This secession movement had been declared illegal by majority of the countries of the world who stated that the decision of Crimea’s secession should be taken based on an all Ukrainian referendum instead.605 On the other hand, Russia has compared the situation in Crimea to that of Kosovo in 2008 and has accused the Western nations of double standards and hypocrisy in the present situation.606 However, it is not the secession, but the rampant violation of human rights in Crimea by the Russian troops who attacked and killed several Ukrainian supporters causing rampant destruction of property and life that has troubled the Western nations.607

III. TRADE SANCTIONS AGAINST RUSSIA

The West unanimously held that Russia’s secession of Crimea into its territory was against the international principle of State Recognition and

604 Ibid.
605 Ibid.
606 Ibid.
that Russia was committing a ‘use of force’ in Crimea that is against the recognized International Law obligations. Therefore, many countries imposed trade and political sanctions against Russia.\textsuperscript{608} Common political sanctions imposed by several countries were freezing assets and banning travel for the Russian political elite.\textsuperscript{609} However, the West soon realized that stand-alone political bans would not deter Russia. Hence, it gradually started imposing several trade sanctions to deter Russia and indirectly force it to give up Crimea.\textsuperscript{610} For example, France suspended its delivery of two \textit{Mistral}-class amphibious assault ships to Russia;\textsuperscript{611} Britain suspended military sales and co-operation with Russia; the United States issued Executive Orders in March, 2014 to suspend credit finance that encouraged exports to Russia and finance for economic development projects in Russia.\textsuperscript{612} Additionally, the United States prohibited exportation of goods, services and technology in support of exploration or production for projects that had the potential to produce oil in the Russian Federation.\textsuperscript{613}

The European Council condemned Russia’s acts as a clear violation of the sovereignty and territorial integrity of Ukraine.\textsuperscript{614} It imposed an embargo


\textsuperscript{609} Ibid.

\textsuperscript{610} Ibid.

\textsuperscript{611} Cf Sanctions (n1).

\textsuperscript{612} Public Release, ‘Ukraine and Russia Sanctions’ (US Department of State 2014) \textltt{http://www.state.gov/e/eb/tfs/spi/ukrainerussia/} accessed 01 March 2015.


on the import and export of arms and ammunitions with Russia. It also prohibited exports of dual-use goods and technology for military use in Russia. Moreover, the restrictions governing the prior authorisations by Member States of exports of certain energy-related equipment and technology to Russia were further extended and amended on September 08, 2014 and December 04, 2014 respectively.

Canada also imposed a similar export restriction on Russian arms, energy as well as financial corporations. Correspondingly, Japan too restricted imports from Crimea and froze funds for new projects in Russia. Norway decided to adopt tougher sanctions against Russia than the ones adopted by the European Union and the United States by banning export of equipment, technology and assistance to Russian oil sector.

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All the major nations of the world including United States, nations of the European Unions and Russia\textsuperscript{621} have joined the World Trade Organization. Hence these nations are ‘contracting parties’ under the General Agreement on Tariff and Trade (“GATT”). The abovementioned trade restrictions imposed by the Western nations prohibits imports from Russia. These nations do not place similar import restriction on any other country. This is in clear violation of Article I of GATT that prohibits favourable treatment to one nation over the other nations for custom duties and charges imposed on importation and exportation of goods. Moreover, Article III of GATT mandates that a State should give ‘like’ treatment for national and international goods. In this case, Article III too has been violated as export of arms and related materials has been prohibited from Russia. Therefore, it is evident that restrictions imposed by the Western countries on Russia have \textit{prima facie} violated the obligations under the GATT. Therefore, it is open to Russia to challenge the restrictions imposed on it in the World Trade Law dispute settlement forum.

IV. \textbf{Analysis of the Existing Jurisprudence under Article XXI of the GATT}

Article XXI of the GATT talks about the security exceptions. This exception grants immunity to the State imposing restrictions on the ground that it was doing the same to protect its security interest in the wake of any international unrest. If the sanction imposing nations want to defend themselves from the violation of their GATT obligations while imposing the restrictions on Russia, they will have to plead that it was done to protect their security interest.

At the time of drafting the security exception, it had been decided that the same should not be too strict or too broad as the same would either prohibit

\begin{footnote}
\textsuperscript{621} Russia recently became part of WTO in 2012.
\end{footnote}
genuine measures or enable countries to impose commercial measures in the guise of security exceptions.\footnote{WTO, ‘Article XXI Security Exceptions’ (Analytical Index of the GATT) <https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art21_e.pdf> accessed 01 March 2015.} Since its inception in 1994, the WTO dispute settlement body has never had to adjudicate upon a case wherein the trade sanctions imposed by a party have used the defence of the security exception. There has not been a single instance before the advent of World Trade Organization in 1994 when the case was challenged on the ground of misuse of Security Exception under Article XXI of GATT. However, there have been certain instances where the security exception as a possible defence was deliberated upon.

In \textit{Czechoslovakia v. United States dispute}\footnote{Summary Record of the Twenty-Second Meeting, June 08, 1949, CP.3/SR22-II/28.}, Czechoslovakia argued that the United States had breached its obligations under Articles I and XIII of the GATT by administering export licensing and short-supply controls.\footnote{Ibid.} These controls discriminated amongst destination countries.\footnote{Ibid.} The United States justified these controls by arguing that they were necessary for “security reasons” Article XXI (b) (iii) of the GATT and that it only “applied to a narrow group of exports of goods which could be used for military purposes.”\footnote{Ibid.} Czechoslovakia’s claim was rejected by sixteen out of the seventeen Contracting Parties who held that Article XXI begins with the word “necessary” and hence, United States will not have to adhere to any GATT obligations if it can establish that it has validly used the Article XXI exception.\footnote{Ibid.} They also concluded that every country will have the last say on what matters affect their security interests.\footnote{Ibid.}
Thereafter, in the case of *Swedish Import on Restrictions on Certain Shoes*, Sweden had imposed a global import quota system for certain footwear that was used by the military personnel. Since there was decrease in the domestic production of this footwear, Sweden justified its restriction on the ground that this quota helped in maintenance of minimum production capacity in vital industries and this in turn was necessary to meet the basic needs in case of any emergency. This interpretation of the term “essential security interest” under Article XXI is not definitive as this case never went before the dispute settlement body.

In the dispute between Ghana and Portugal in 1962, Ghana relied on Article XXI to restrict its trade with the new member Portugal. It held that Portugal’s policies concerning its African territories had led to an emergency in international relations under Article XXI (b)(iii) and therefore, it was justified in boycotting goods from Portugal. One interesting aspect that came out in this case was that Ghana asserted that the “danger” may be actual or potential. It argued that the situation in Angola was a constant threat to international peace and by bringing trade measures, Ghana intended to pressurise the Portuguese government to act in direction of lessening the danger. Since no formal complaint was launched with the dispute settlement body of the WTO, Ghana’s assertions could not form the definitive interpretation of Article XXI.

In 1982 European community, Canada and Australia indefinitely suspended imports from Argentina. These measures were taken to address the

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629 *Sweden-Import Restrictions on Certain Footwear*, L/4250 (November 17, 1975).
630 Ibid.
631 cf WTO (n38).
632 Ibid.
633 Ibid.
634 Ibid.
Security Council Resolution 502 (the Falkland/Malvinas issue). The background to this resolution was that Argentina had engaged in an armed attack in the Falkland Islands. Argentina sought the interpretation of Article XXI from the other contracting parties in the wake of these restrictions. After detailed discussion by the contracting parties, a “Decision Concerning Article XXI of the General Agreement” was adopted. This decision lays down certain procedural safeguards that each State imposing trade restrictions under Article XXI should follow. The salient features are:

a. The contracting party upon whom the trade restrictions are being imposed should be informed about the measures to the fullest possible extent,

b. The contracting party upon whom the trade sanctions are being imposed has the full right to challenge this action under the dispute settlement mechanism,

c. The council may be requested to give further consideration in this matter in the due course of time.

This decision merely lays down some procedural guidelines but does not aid in any substantive interpretation of Article XXI.

Thereafter, the United States justified its trade restriction under the cloak of Article XXI at two instances. In the first instance, the United States prohibited all imports and exports to and from Nicaragua because the policies and actions of the latter’s government constituted “an unusual and extraordinary threat to the national security and foreign policy of the United

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636 Ibid.
637 Ibid.
638 Ibid.
639 Ibid.
640 Ibid.
States”. Nicaragua contended that it is impossible for a small country like itself to constitute an extraordinary threat to United States’ national security. India too contended that there should have been a genuine nexus between the essential security interest and the trade sanctions for imposing such drastic trade measures. United States defended its position by stating that the other contracting parties had no locus standi to question the validity of or motivation for invocation of article XXI (b) (iii). After long negotiations, the Council stated that “the panel cannot examine or judge the validity of or motivation for the invocation of Article XXI (b) (iii) by the United States”. This meant that the determination of the “essential security interest” has remained the sole prerogative of the nation invoking Article XXI (b) (iii).

In another instance, the United States passed Cuban Liberty and Solidarity Act, 1996 also known as the Helms-Burton Act in response to a Cuban jet shooting down unarmed civilian planes, killing four people, including three American citizens. The controversial portions of this Act are Title III and Title IV. Title III imposed damages on foreign companies that dealt in the property of United States nationals that had been confiscated by the Cuban government. Title IV imposed further restrictions on United States persons

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645 Ibid.
646 Exiles Commemorate Downing of Planes by Cuba 5 Years Ago, CHI. TRIB., Feb. 25, 2001, at C7 as seen in cf Lindsay (n58).
who trafficked in the above said property.\textsuperscript{648} This legislation was opposed by Canada, Mexico and the European Union as the same violates the principles of free trade under GATT. Eventually, the parties resolved their differences by mutual consultation and compromises without involving WTO adjudicatory bodies.\textsuperscript{649} Thus, the abovementioned instances conclude that the States have taken the aid of Article XXI to justify violation of their obligations under the GATT. However, the WTO dispute settlement body has, so far, not given any decision supporting or opposing the justification of Article XXI.

Leading international trade law scholars have stated that that the sanctioning members are not obliged to justify their determination of ‘essential security interest’ under Article XXI to the World Trade Organisation or its members.\textsuperscript{650} Furthermore, the sanctioning member does not require any prior approval or subsequent ratifications of its measures from the World Trade Organisation.\textsuperscript{651} Therefore, the only conclusion with regard to the substantive interpretation of Article XXI is provided by the Council in United States v Nicaragua\textsuperscript{652} dispute which held that the determination of ‘essential security interest’ is left on the State invoking Article XXI. The other jurisprudence under Article XXI comprises mainly of the contentions and assertions made by the affected parties when they had violated their obligations under the World Trade Law. Hence, the limited jurisprudence under Article XXI leaves a wide scope for its interpretation in any future dispute where Article XXI is used as a defence for violation of provisions under the GATT.

\textsuperscript{648} 22 U.S.C.A. § 6091(a) (West Supp. 2002).
\textsuperscript{649} cf Lindsay (n58).
\textsuperscript{651} ibid.
\textsuperscript{652} cf United States v Nicaragua (n59).
V. Application of Article XXI Defence in the Present Case

The GATT has two kinds of exceptions – general exceptions under Article XX and security exceptions under Article XXI. In order to apply a general exception under Article XX, a State needs to follow a two pronged test. A State first needs to establish that the imposed restriction falls under any one of the ten categories under Article XX. Thereafter, the State has to ensure that the restriction is in compliance with the chapeau which states that the exception “would not constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade”.

The grounds for general exception under Article XX relate to instances where the concerned State will be affected by action of any other State. While the security exception under Article XXI is invoked when the action of other State imposes threat to its national security interests. Hence the requirement of chapeau is absent from Article XXI. Therefore, the restrictions imposed by any country on the ground of security exception can be targeted at one particular country instead of applying them across the board for all the nations, like the restrictions under Article XX. Therefore, the sanction imposing nations can unilaterally impose restrictions on Russia under Article XXI.

There are two aspects to Article XXI – a procedural and a substantive aspect. The procedural aspect is the guidelines laid down in the “Decision Concerning Article XXI of the General Agreement” that was adopted by the Contracting Parties in 1982. The main crux of the procedural requirement is that the State against whom the restrictions have been imposed will need to be made aware of the full extent of the measures. In the present case of trade

653 Article XX, General Agreement on Tariff and Trade 1994.
654 cf Decision of 30 November 1982 (n51).
655 Ibid.
restrictions against Russia, it has been observed that the countries who have imposed trade restrictions on Russia have widely publicized their restrictions through their official websites as well as through the popular media. Hence, it can be safely concluded that the countries that have imposed restrictions on Russia have followed the procedural requirement of notification of the restrictions.

Now that it is established that the sanction imposing states had followed the basic procedural requirements essential for imposing sanctions under Article XXI of GATT, the next issue that needs to be examined is whether the sanction imposing nations have followed all the substantive requirements that are necessary for imposing sanctions under Article XXI. Sanction imposing nations intending to defend their actions under Article XXI(b)(iii) of GATT will have to prove that their measures were taken in time of emergency in international relations. The text of Article XII (b) (iii) necessitates the fulfilment of three substantive requirements for successfully invoking the said Article. Firstly, the sanction imposing country will have to prove that the measures were taken in the time of “emergency in international relations”. Secondly, that country will have to prove that there has been a threat to its “essential security interest”. Lastly, it will have to prove that the measures that have been taken are “necessary” to protect its essential security interest. The next section shall critically analyse whether each of the three substantive requirements have been fulfilled by the sanction imposing countries in the present case.

A. The measures were taken in time of emergency in International relations

This is the factual interpretation and the same needs to be determined by the concerned countries. The following contentions can be raised by the parties:
Russia's argument

Russia could argue that if the sanction imposing nations believe that the secession in Crimea is illegal, then the same could have been dealt with by collective action under the United Nations charter. The United Nations' charter lays down detailed procedure for determining whether there has been any use of force against territorial integrity and political independence of any other State. 656 If there is a ‘use of force’ by one country against the other, then the said dispute needs to be resolved by peaceful methods such as mediation, conciliation, negotiation or judicial settlement. 657 If the matter is not resolved by peaceful means, only the United Nations has the power to act. 658 To do so, the Security Council will have to determine the existence of threat to peace. 659 Thereafter, it shall decide the collective measures to be adopted against the erring party. 660 In the present case, the nations that imposed trade sanctions on Russia unilaterally and arbitrarily decided that the situation in Crimea is a threat to international peace without resorting to the pacific dispute settlement means under Chapter VI of the United Nations charter.

There are instances where the Security Council will be unable to act as its members are parties to the dispute concerned. In such cases, The United Nations provides for United for Peace Resolution 661. As per the said resolution, the General Assembly shall issue any recommendations it deems necessary to restore international peace and security when Security Council

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656 Article 2 (4) of the United Nations Charter.
657 Article 33 (1) of the United Nations Charter.
is unable to help. In the present situation, if it is argued that the Security Council was unable to help, then the General Assembly had the power under Resolution 377A to issue United for Peace Resolution. However, the sanction imposing countries disregarded the dispute settlement mechanisms that were available to them under various international charters and unilaterally imposed the trade restrictions on Russia.

Russia could also argue that due process of law and democratic methods was followed in Crimea. The citizens of Crimea voluntarily decided to join the Russian Federation. Moreover, the treaty of secession between Russia and Crimea was also ratified by the Russian Parliament. Therefore, the secession pact between Russia and Crimea is purely a bilateral affair between the two nations and therefore, no other nation has any *locus standi* to interfere in their bilateral affairs.

Moreover, the objective of the GATT is to ensure that there is a rise in the standard of living of the population and steady growth in the volume of real income by expanding the production as well as the exchange of goods. Therefore, since GATT primarily deals with the promotion and protection of free trade among nations, it should not be used as a political tool by the nations to further their own economic self-interest.

*Arguments by the sanction imposing countries*

The concerned States that have imposed the measures on Russia can defend their action by demonstrating that Russia’s actions violated basic principles of international law. The fundamental principle of territorial integrity was interpreted further and expounded in the United Nations General Assembly ‘Friendly Relations Declaration’. This resolution primarily stated that ‘any total or partial disruption of the national unity or territorial integrity of the

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662 Objective of General Agreement on Tariffs and Trade, 1947 ([Bare text](#)).
State... is incompatible with the principles of the [United Nations] Charter. Moreover, the principle of sovereign equality under Article 2(1) of the United Nations Charter presupposes the existence of territorial integrity and political independence. The act of interference by the Russian troops with the internal protests in Crimea is an attempt to disrupt the national unity of Ukraine and hence Russia has breached the customary international law principle of territorial integrity.

Furthermore, a valid secession requires full consent of the concerned government. In the present case, the mayor appointed by the Central Government was ousted by the Russian revolutionary forces at the time when the Ukraine government was struggling after the EuroMaidan revolution. In the said circumstances, Crimea could not have validly seceded to Russia as it failed to wait for the restoration of effective government in Ukraine before holding the referendum that declared Crimea to be a part of Russia.

The sanction imposing nations could also claim that Russia’s argument of valid self-determination by the people of Crimea would not sustain as the principle of self-determination encompasses two aspects – the internal and the external. The internal aspect refers to the right of the people to

664 Ibid.
665 Ibid.
determine their political status and the external aspect refers to the right of the people to freely determine their place in the international arena.\textsuperscript{669} There have been reports from non-Russians that have stated that the referendum was done only in the Russian speaking region of Crimea.\textsuperscript{670} The presence of Russian troops in Crimea at the time of referendum also raises doubts about the free will of the Crimean citizens when they voted for secession. Therefore, it can be strongly presumed that the internal aspect of self-determination has been vitiated in the present case.

As Russia has violated fundamental customary international law obligations, Article 2(4) of the United Nations charter and its commitments under several bilateral and multilateral treaties,\textsuperscript{671} the other nations across the globe were justified in raising concerns regarding the rampant human rights violation by Russian troops in Crimea as well as the breach of territorial integrity of Ukraine. The shooting of Malaysian Airline Flight 370 in a territory controlled by the pro-Russian separatists further enraged the international community.\textsuperscript{672} The sanction imposing nations did not expect the United Nations to take collective security in this situation as Russia is one of the five permanent members in the Security Council, thus enjoying veto power.\textsuperscript{673} Since the United Nations Security Council is crippled in this case,

\begin{itemize}
\item \textsuperscript{669} Ibid.
\item \textsuperscript{670} Cf Simferopol (n23).
\item \textsuperscript{673} Article 27 of the United Nations Charter.
\end{itemize}
the General Assembly passed a resolution\footnote{United Nations General Assembly Resolution 68/262 (March 27, 2014) 68th Session of UN General Assembly.} stating that the referendum held in the Autonomous Republic of Crimea and the city of Sevastopol on 16 March 2014 was not authorized by Ukraine.\footnote{It is to be noted that 100 countries voted in favour of the resolution while 11 countries voted against it and 58 countries remained absent for the vote.} Therefore, the resolution called upon the States to refrain from actions aimed at partial or total disruption of the national unity and territorial integrity of Ukraine, including any attempts to modify Ukraine’s borders through the threat or use of force or other unlawful means as the same would amount to a violation of the Declaration on Principles of International Law concerning Friendly Relations and Cooperation among States.\footnote{Ibid.} Russia went ahead with secession of Crimea into its territory, thus disregarding the General Assembly Resolution 68/262. This left the countries around the globe, who were signatories of the said resolution with two options – either to deploy their troops to Ukraine and fight against the Russian military or to use economic measures to indirectly force Russia to stop the blatant human rights violation in Crimea. The act of deploying military troops in Ukraine would have escalated the dispute and hence, several countries in the West decided to impose trade sanctions to indirectly compel Russia to stop the rampant violation of human rights and destruction of life and property in Crimea by the Russian forces. Thus, it can be concluded that the acts of sanction imposing nations were undertaken as a method of last resort after the peaceful mechanism of asking Russia to refrain from using unlawful means in Crimea region through the passage of the General Assembly Resolution had failed.
B. Threat to essential security interest

Russia’s arguments

Although the determination of essential security interest is subjective and has been left on the concerned country, there should be a reasonable nexus between the sanctions imposed and the threat that the sanction imposing country is facing. In this case, the countries like United States and nations of European Union had no imminent or potential threat from the secession of Crimea by Russia. Russia could further argue that Article XXI has been has not been designed for a hyper-sensitive government. Therefore, each sanction imposing country will have to show that there had been a credible threat to the respective nations and not simply cry wolf.

Arguments by the sanction imposing countries

In the present era of globalisation, there is an increased dependence of one country on another. Therefore, the sanction imposing countries can claim that if basic human rights are violated in one country, then it could have a spill-over effect on other nations as well. Moreover, secession of one nation by another without following the principles of international law like non-interference in domestic matters of another nation and not following the principles of use of force as enshrined in Article 2(4) of the United Nations Charter is not acceptable in the present century and hence, the sanction imposing countries have well-founded fears that if Crimea’s situation is left unattended to, then it could lead to potential threats to their sovereignty as well. The case of Ghana-Portugal trade sanctions clearly states that the danger need not only be actual but it could also be potential.\(^67\) Russia’s illegal secession is a potential threat to the security interests of all the nations around the globe and hence this move needs to be nipped in the bud. Moreover, it can be argued that the very fact that security exception that stems from the

\(^67\) cf WTO (n38).
fear of political upheaval has been provided under the financial treaty such as GATT implies that the makers had envisaged situations where the countries would need to use economic measures to meet political ends.

C. The measures were “necessary” to safeguard the national interest of the concerned country

If the sanction imposing countries are able to successfully plead the first two criteria, then they would need to prove that the necessity of their specific sanctions to safeguard their security interests. There is no case under Article XXI where the word ‘necessary’ has been interpreted. General rule of treaty interpretation states that ordinary meaning shall be given to the terms of the treaty ‘in their context and in light of its object and purpose’.

The contexts in which Article XX and Article XXI of GATT were drafted are similar as both these Articles provide exceptions that allow deviations from the obligations under the GATT. Since both these Articles use the term ‘necessary’, therefore, the interpretation of the term ‘necessary’ under Article XX could aid in the possible interpretation of the term ‘necessary’ under Article XXI. However, under Article XXI, the word ‘necessary’ has been qualified by the term ‘essential security interest’. Therefore, to impose any restriction under Article XXI, the State will have to first determine that the restriction has been imposed to safeguard its ‘essential security interest’. The State is allowed to impose any restriction under Article XXI that it deems ‘necessary’ to protect its ‘essential security interest’. The determination of ‘essential security interest’ under Article XXI is left to the concerned State. Therefore, once a country determines that the act of any other country is a threat to its ‘essential security interest’, then, it shall

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678 Ibid.
680 cf United States v Nicaragua (n59).
have the power to impose any measure that it deems ‘necessary’ in that situation.

The term ‘necessary’ has been used in Article XX at three instances: first, to protect public morals; second, to protect human, animal or plant life or health; and finally, to ‘secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement’. While interpreting the term ‘necessary’ under Article XX, it has been held that the same should be judged by assessing the extent to which the measure ‘contributes to the realization of the end pursued’. Moreover, ‘necessary’ measure not only includes ‘indispensable’ measure but also includes any measure that is deemed necessary in a particular situation. Furthermore, it is not required to ensure that the measure must achieve its result with absolute certainty.

The sanction imposing nations have claimed that Russia’s action in Crimea violates the international peace and security and hence it is an ‘essential security threat’ to their sovereignty as well. They may argue that their sanctions come within the purview of ‘necessary’ measures since these have

681 Article XX (a) of the General Agreement to Tariff and Trade, 1947.
682 Article XX (b) of the General Agreement to Tariff and Trade, 1947.
683 Article XX (d) of the General Agreement to Tariff and Trade, 1947.
gradually increased the gravity of their sanctions based on the changing political scenario. Moreover, initially, the Western nations imposed political sanctions like travel and visa restrictions on the political elites. When the Western nations realized that the political sanctions have failed to deter Russia, then these nations gradually imposed restrictions on financing and trade of arms and ammunition related sectors. It can be asserted that arms and ammunition sector has a direct impact on Russia’s deployment of military forces in Crimea and hence the financial and trade restriction on arms and ammunition related sector was ‘necessary’ to deter Russia from undertaking any further military actions in Crimea.

VI. CONCLUSION

This paper has evaluated the arguments that the sanction imposing states and Russia can take if the trade sanctions are challenged before the dispute settlement body of the World Trade Organisation. Russia will primarily argue that the sanction imposing nations are detrimentally affecting the Russian economy by restricting free trade in the cloak of political upheaval and are misusing the restrictions granted under Article XXI of GATT. It will further state that the sanction imposing nations should have ideally resorted to peaceful dispute settlement mechanisms provided under the United Nations Charter instead of unilaterally imposing the measures against Russia. It can also claim that the situation in Crimea in no way affects the ‘essential security interest’ of nations like Japan and United States and hence it does not necessitate the use of Article XXI which should ideally be used as a means of last resort. On the other hand, the sanction imposing nations will assert that Crimea’s secession to Russia is a threat to international peace and security. Moreover, it will argue that the measures undertaken were absolutely necessary to prevent Russia from violating Ukraine’s territorial sovereignty and from causing rampant violation of human rights in Crimea.
As seen in this paper, many countries have imposed trade restrictions during political disputes in the latter half of the twentieth century. Most of these nations have defended their trade restrictions under the security interest. However, the dispute settlement body under the WTO did not have opportunity to decide on the same as most of these disputes were settled with mutual consultation and compromise. If Russia brings its trade dispute to the WTO dispute adjudication body, then it will set a precedence by giving the dispute settlement body an opportunity to examine and interpret the use of security exception under Article XXI of the GATT.