

## TRADE LAW AND SUPPLY CHAIN REGULATION IN A POST-COVID-19 WORLD

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### ABSTRACT

*This Essay argues that trade agreements may overly constrain the ability of states to regulate supply chains for critical products such as medical supplies. Free trade agreements (FTAs) may exacerbate supply chain concentration, especially through loose rules of origin. And WTO rules constrain preventative regulation of supply chain risks designed to prevent a crisis, while providing exceptions for aggressive action only in the face of a crisis. Thus, WTO members risk flouting WTO rules if they do not limit aggressive, preventative supply chain regulation.*

### I. INTRODUCTION

COVID-19 hit as the world was undergoing the most significant upheaval in the international trade regime since the creation of the World Trade Organization (WTO) in 1995. Although the challenge to the WTO has a number of facets, a core element is a contest over government policies that seek to influence the location of supply chains. In recent decades, a range of Chinese policies have had the effect of concentrating many global supply chains in that country.<sup>1</sup> Other large emerging economies have adopted policies with similar effects. The WTO's Appellate Body interpreted WTO rules on so-called trade remedies in ways that limited the ability of developed members like the United States and the European Union (EU) to effectively counteract such policies. In response, the Trump administration made "reshoring"—the practice of shifting production operations to the "home" country of the parent corporation<sup>2</sup>—a central talking point.

COVID-19 has accelerated this call for supply chain regulation in the United States, Europe, and elsewhere.<sup>3</sup> When the crisis hit, many developed countries realized that their

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<sup>1</sup> WAYNE M. MORRISON, CONG. RES. SERV., THE MADE IN CHINA 2025 INITIATIVE: ECONOMIC IMPLICATIONS FOR THE UNITED STATES, 1 (2019) ("Recent proposals by the Chinese government, such as its 'Made in China 2025' initiative, appear to signal an expanded role by the government in the economy, which many fear could distort global markets and negatively affect U.S. firms."); see also Willy Shih, *Is It Time to Rethink Globalized Supply Chains?*, MIT SLOAN MGMT. REV. (Mar. 19, 2020), at <https://sloanreview.mit.edu/article/is-it-time-to-rethink-globalized-supply-chains>.

<sup>2</sup> Lisa M. Ellram, *Offshoring, Reshoring and the Manufacturing Location Decision*, 49 J. SUPPLY CHAIN MGMT., 2, 3–5 (2013).

<sup>3</sup> See, e.g., Klaus Ulrich, *Coronavirus Outbreak Hitting German Supply Chains with Fears of Economic Paralysis*, DW (Feb. 27, 2020), at <https://www.dw.com/en/coronavirus-outbreak-hitting-german-supply-chains-with-fears-of-economic-paralysis/a-52554823>; Todd Tucker, *Coronavirus Will Change How We Think About Supply*

supply chains for critical medical supplies and pharmaceuticals were concentrated in China and elsewhere. When the pandemic temporarily halted production in China, developed countries faced significant shortages of medical supplies. As a result, approximately eighty nations restricted the export of such products.<sup>4</sup> At the same time, calls to use trade policy as a tool for supply chain regulation spread. Most prominently, former U.S. Vice President Joe Biden, the 2020 Democratic nominee for president, has called for “modernizing international trade rules to secure U.S. and allied supply chains”—a sure sign that global supply chain regulation will remain on the agenda next year regardless of who the U.S. president is.<sup>5</sup>

This Essay argues that modern trade agreements may overly constrain the ability of states to regulate supply chains for critical products such as medical supplies. I make two primary points. First, I argue that modern free trade agreements (FTAs), the primary vehicle through which trade liberalization has proceeded since 1995, do little to encourage the diversification of supply chains and in some cases actually exacerbate supply chain risks, especially through loose rules of origin. Second, I argue that WTO rules constrain aggressive regulation of supply chain risks designed to prevent a crisis, while providing exceptions for aggressive action only in the face of a crisis. WTO members are thus put to a choice. They can limit their attempts to preventatively regulate supply chain risks, waiting until a crisis occurs, or they can flout WTO rules. The former option risks more supply chain crises, while the latter option risks further undermining support for and adherence to the multilateral trading system. In this sense, trade law finds itself at a juncture similar to that faced by rules on the use of force two decades ago. Both sets of rules contain limited exceptions for preemptive action in the face of imminent threats. Just as nations like the United States felt that the imminence requirement did not give them enough flexibility to respond to modern threats in the use of force context, so too will nations chafe at the narrow exceptions for crisis-based supply chain regulation in the trade context.

## II. HOW TRADE LIBERALIZATION IN PRACTICE CAN PROMOTE SUPPLY CHAIN CONCENTRATION

### A. *Managing Supply Chain Risks Through Trade Liberalization*

Free trade advocates have historically argued that reducing trade barriers better promotes a range of objectives that supply chain regulation, and in particular reshoring and localization of supply chains, is thought to serve. Export-oriented production supports large numbers of jobs, including the kinds of manufacturing jobs that localization is said to support.<sup>6</sup> Cheaper imports of natural resources and intermediate products support production in the higher end of the value chain, even if the finished products are only destined for domestic

*Chains*, MEDIUM (Mar. 20, 2020), at <https://medium.com/@toddtucker/coronavirus-will-change-how-we-think-about-supply-chains-6a2b82d50cf7>.

<sup>4</sup> See World Trade Organization Secretariat, *Export Prohibitions and Restrictions* (Apr. 23, 2020), available at [https://www.wto.org/english/tratop\\_e/covid19\\_e/export\\_prohibitions\\_report\\_e.pdf](https://www.wto.org/english/tratop_e/covid19_e/export_prohibitions_report_e.pdf).

<sup>5</sup> Biden for President, *The Biden Plan to Ensure the Future of “Made in All of America” by All of America’s Workers*, at <https://joebiden.com/madeinamerica>.

<sup>6</sup> Koen De Backer, Carlo Menon, Isabelle Desnoyers-James & Laurent Moussiégt, *Reshoring: Myth or Reality?*, 27 OECD SCI., TECH. & INDUS. POL’Y PAPERS 6 (2016) (“The main argument—and hope—is that reshoring will create value added and jobs . . .”).

consumption.<sup>7</sup> And by enabling more efficient production of goods and services, trade liberalization reduces costs to consumers, enabling more efficient allocation of resources and ultimately increasing consumer welfare.<sup>8</sup>

Similarly, commentators have argued that trade liberalization mitigates supply chain risks better than active government regulation.<sup>9</sup> Reducing trade barriers allows firms to draw on supplies that are located in different parts of the world, enabling diversification of supply chains.<sup>10</sup> Diversification, in turn, reduces supply chain risk. An outbreak in China or a nuclear meltdown in Japan may create short-term stress on supply chains, but the availability of alternative suppliers in other countries allows firms to quickly restore supply lines.

Reshoring and localization, on this view, exacerbates supply chain vulnerabilities by forcing firms to locate production within a single country. While reshoring may protect a country from supply chain disruptions in other countries, it makes them considerably more vulnerable to supply chain disruptions in their own country.<sup>11</sup> The COVID-19 outbreak in the United States illustrates this point. As the United States has emerged as one of the hardest hit countries in the world, the food supply chain came under threat.<sup>12</sup> Meat plants in particular have suffered high rates of infection, causing closures sufficiently severe that President Trump issued an order under the Defense Production Act to keep meat plants open.<sup>13</sup> Moreover, localization and the tactics that encourage it—such as the imposition of WTO-inconsistent tariffs—may provoke retaliation and therefore lead to an overall increase in trade barriers.<sup>14</sup> Localization, in sum, has the potential to increase both the risks of supply chain disruptions and the risks from other governments' trade policies.

### *B. Trade Rules Do Little to Limit Emerging Economies' Industrial Policy*

But while trade liberalization has huge benefits and can lead to diversification in some circumstances, no reason exists to think that firms' private choices as to where to locate their production facilities will in general lead to supply chains for critical products that are diversified and resilient. Indeed, in practice, trade agreements and national policies can lead to the concentration of supply chains in one or a few countries.

<sup>7</sup> Synthesis Report, *Interconnected Economies: Benefiting From Global Value Chains*, OECD SCI., TECH. & INDUS. POL'Y 17 (2013).

<sup>8</sup> *Id.*; see also De Backer, Menon, Desnoyers-James & Moussiégt, *supra* note 6.

<sup>9</sup> See COVID-19 AND TRADE POLICY: WHY TURNING INWARD WON'T WORK (Richard E. Baldwin & Simon J. Evenett eds., 2020) [hereinafter "COVID-19 AND TRADE POLICY"] and contributions therein.

<sup>10</sup> Samson Ngugi, *Trade Facilitation and Global Supply Chains: The Role of FTA Trade Facilitation Rules in Promoting Global Supply Chains*, MEDIUM (Dec. 31, 2019), at <https://medium.com/@samsonngugioffice/free-trade-is-always-good-448dc551d04a>.

<sup>11</sup> Sébastien Miroudot, *Resilience Versus Robustness in Global Value Chains: Some Policy Implications*, in COVID-19 AND TRADE POLICY, *supra* note 9 ("Fully localised production is not recommended for robustness as the disaster can happen within a domestic economy.").

<sup>12</sup> See Taylor Telford, Kimberly Kind & Jacob Bogage, *Trump Orders Meat Plants to Stay Open in Pandemic*, WASH. POST (Apr. 29, 2020), at <https://www.washingtonpost.com/business/2020/04/28/trump-meat-plants-dpa>.

<sup>13</sup> Alex Gangitano, *Trump Uses Defense Production Act to Order Meat Processing Plants to Stay Open*, HILL (Apr. 28, 2020), at <https://thehill.com/homenews/administration/495175-trump-uses-defense-production-act-to-order-meat-processing-plants-to>.

<sup>14</sup> The Trump administration's steel and aluminum tariffs illustrate the point. See, e.g., Menzie Chinn, *What Is the National Security Rationale for Steel, Aluminum and Automobile Protection?*, ECONOFACT (June 6, 2018), at <https://econofact.org/what-is-the-national-security-rationale-for-steel-aluminum-and-automobile-protection>.

A range of national policies, as well as labor market conditions, influences firms' choices as to where to locate their production facilities. Commentators have long understood that if barriers to international trade fall, firms will reduce their costs by shifting their supply chains to countries with lower regulatory and environmental standards.<sup>15</sup> More recently, though, policymakers have focused on industrial policy in major emerging economies, most notably China, as another factor in firms' decisions.<sup>16</sup> WTO rules, it turns out, do little to limit these policies in practice.

China, for instance, offers substantial subsidies to firms that operate there, thereby reducing their production costs.<sup>17</sup> These subsidies are often nontransparent. Many come from state-owned or state-influenced banks.<sup>18</sup> These two factors make China's subsidy policy difficult to get at under the WTO Agreement on Subsidies and Countervailing Measures.<sup>19</sup>

China also has a de facto policy requiring foreign firms to transfer technology to Chinese firms.<sup>20</sup> As a result, Chinese firms are able to accumulate the best technology from around the world at a low cost. They become the most efficient producers in part because they have not had to incur the research and development costs that foreign firms have had to incur. Technology transfer of this kind is, at a minimum, difficult to challenge at the WTO and may be outside WTO rules entirely.<sup>21</sup>

Third, resource rich countries—including China, Indonesia, and Argentina—impose export restraints of various kinds on products used early in supply chains.<sup>22</sup> These export restraints reduce the price of inputs within the protected market, making it cheaper for firms to locate production facilities higher up the value chain within the country. WTO rules generally forbid export quotas or embargoes. But countries can use export duties, which are generally legal under WTO rules, to accomplish the same purpose.<sup>23</sup>

<sup>15</sup> See e.g., Aaron Friedberg, *The United States Needs to Reshape Global Supply Chains*, FOR. POL'Y (May 8, 2020), at <https://foreignpolicy.com/2020/05/08/united-states-reshape-global-supply-chains-china-reglobalization> (“the capacity to manufacture drugs and active pharmaceutical ingredients has moved from the United States and Europe to developing countries in Asia where costs are lower and environmental regulations more relaxed”).

<sup>16</sup> See generally OFFICE OF THE U.S. TRADE REPRESENTATIVE, FINDINGS OF THE INVESTIGATION INTO CHINA'S ACTS, POLICIES, AND PRACTICES RELATED TO TECHNOLOGY TRANSFER, INTELLECTUAL PROPERTY, AND INNOVATION UNDER SECTION 301 OF THE TRADE ACT OF 1974 (2018) [hereinafter 301 REPORT].

<sup>17</sup> While China is far from the only country that uses such policies or presents supply chain concentration issues, I focus on China because it is the largest such economy and has been the focus of much public commentary.

<sup>18</sup> Mark Wu, *The “China, Inc.” Challenge to Global Trade Governance*, 57 HARV. INT'L L.J. 261, 301–04 (2016) (describing the WTO debate on how these subsidies should be categorized).

<sup>19</sup> *Id.* at 315.

<sup>20</sup> *Id.* at 297; see also 301 REPORT, *supra* note 16.

<sup>21</sup> Simon Lester, *Forced Technology Transfer and the WTO*, INT'L ECON L. & POL'Y BLOG (Mar. 29, 2018), at <https://worldtradelaw.typepad.com/ielpblog/2018/03/forced-technology-transfer-and-the-wto.html> (discussing the United States' view that many Chinese policies aimed at technology transfer are outside WTO law).

<sup>22</sup> See Panel Report, European Union—Anti-dumping Measures on Biodiesel from Indonesia, WTO Doc. WT/DS480/R (adopted Feb. 28, 2018); Appellate Body Report, European Union—Anti-dumping Measures on Biodiesel from Argentina, WTO Doc. WT/DS473/AB/R (adopted Oct. 26, 2016); Appellate Body Report, China—Measures Related to the Exportation of Various Raw Materials, WTO Doc. WT/DS394/AB/R (adopted Jan. 30, 2012) [hereinafter China Appellate Body Report].

<sup>23</sup> See General Agreement on Tariffs and Trade 1994, Art. XI, Oct. 30, 1947, 55 UNTS 194 [hereinafter GATT] (“No prohibitions or restrictions other than duties, taxes or other charges . . . shall be instituted or maintained by any contracting party . . .”). China did agree to limits on export duties for some products when it joined the WTO. World Trade Organization, Ministerial Declaration of 10 November 2001, WTO Doc. WT/L/432 (2001).

### C. FTAs Have Been an Ineffective Response

Since WTO rules inadequately restrain these policies, the Obama administration attempted to use FTAs to get at the problem. Its plan was to first negotiate the Trans-Pacific Partnership (TPP), which would encircle China by bringing most major economies on the Pacific Rim into a single free trade area.<sup>24</sup> A contemplated FTA with the EU, the Trans-Atlantic Trade and Investment Partnership (TTIP), would have brought the EU and the United States into a free trade area as well.<sup>25</sup> WTO rules contain an exception that allows nations to discriminate in favor of countries within a free trade area.<sup>26</sup> Thus, these FTAs, the thinking went, could offset the incentives for firms to locate in China (or India, for that matter) by raising the relative cost of market access for goods from outside the free trade area.

Rules like those in the TPP risk reinforcing China's position, however.<sup>27</sup> In the age of supply chains, one of the most important—but often overlooked—provisions of trade agreements are the so-called rules of origin. These rules determine the “nationality” of a product for purposes of applying trade barriers like tariffs. In FTAs, the rules of origin determine how much of a finished product must actually have been produced within the free trade area for the product to qualify for preferential treatment.<sup>28</sup> Rules of origin that allow 50 percent or more of the product to be produced outside the free trade area do little to encourage supply chains to relocate to within the free trade area. Indeed, by creating a free trade area that can be fed by supply chains from outside the area, an FTA can actually reinforce the benefits of industrial policy by countries like China.<sup>29</sup>

This problem is particularly acute for medical equipment, where TPP only requires 30 percent of regional content to qualify for duty-free movement among TPP members.<sup>30</sup> The remaining 70 percent can come from elsewhere. As a result, TPP and other FTAs with weak rules of origin extend the benefits of its trade liberalizing rules to nonmembers like China, without requiring those countries to meet any of the agreement's requirements. Hardly a strategy to counter supply chain concentration.

## III. EMERGENCY EXCEPTIONS EXACERBATE THE CHALLENGE

If trade liberalization, as currently practiced, does little to mitigate supply chain risks, then at least it might allow states the policy space to do so on their own. Unfortunately, much as

<sup>24</sup> Mireya Solís, *The Containment Fallacy: China and the TPP*, BROOKINGS (Mar. 24, 2013), at <https://www.brookings.edu/blog/up-front/2013/05/24/the-containment-fallacy-china-and-the-tpp>.

<sup>25</sup> Eur. Comm. Press Release, EU Negotiating Texts in TTIP (July 14, 2016), at <https://trade.ec.europa.eu/doclib/press/index.cfm?id=1230>.

<sup>26</sup> GATT, *supra* note 23, Art. XXIV; General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, Art. V, 1869 UNTS 183, 33 ILM 1167 (1994).

<sup>27</sup> Although the United States declined to ratify the TPP, see Presidential Memorandum Regarding Withdrawal of the United States from the Trans-Pacific Partnership Negotiations and Agreement, 82 Fed. Reg. 8497 (Jan. 23, 2017), the other eleven members went ahead with the agreement.

<sup>28</sup> World Trade Organization, Technical Information on Rules of Origin, at [https://www.wto.org/english/tra-top\\_e/roi\\_e/roi\\_info\\_e.htm](https://www.wto.org/english/tra-top_e/roi_e/roi_info_e.htm).

<sup>29</sup> Beth Balzan, *What Is the Purpose of an FTA?*, AM. PHX. TRADE ADVISORY SERV. (Mar. 31, 2020), at <http://americanphoenixpllc.com/what-is-the-purpose-of-an-fta>.

<sup>30</sup> *Id.*

rules on the use of force traditionally allow preemptive action only in response to an imminent threat, existing WTO rules give states flexibility in actively managing supply chain risks only during crises. During ordinary times, trade law offers considerably less flexibility for aggressive preventative measures. As a consequence, trade law can put states to a choice between mitigating risks and complying with multilateral rules.

### A. Policy Space at the WTO

To be sure, WTO rules leave states with substantial policy space to adopt certain kinds of measures. Perhaps the most effective such measure is subsidies for firms that diversify their supply chains geographically or adopt other kinds of measures to bolster supply chain resilience. Japan, for instance, recently unveiled “China exit” subsidies for firms that relocate production from China to Japan or Southeast Asia.<sup>31</sup> Subsidies have limits, however.<sup>32</sup> Politically, democracies may have trouble justifying subsidies for private firms, particularly on a scale similar to that provided by countries like China. Subsidies may also be unlawful under domestic law.<sup>33</sup> A global program of subsidizing domestic production in critical supply chains risks the kind of jurisdictional competition that has emerged in the tax area, much to the detriment of governments’ treasuries.<sup>34</sup> And subsidies can still be challenged at the WTO, especially if they are provided transparently as democracies are more apt to do.<sup>35</sup>

Similarly, governments can stockpile critical supplies without running afoul of trade rules. The Agreement on an International Energy Program, the Organisation for Economic Co-operation and Development’s response to the 1970s oil embargo by Arab states, establishes an international framework for just this kind of stockpiling.<sup>36</sup> However, like subsidies, stockpiling requires more of a financial commitment by governments. It also requires governments to identify individual products to stockpile and to ensure their stockpiles are usable in the event the stockpiled goods are perishable.<sup>37</sup> Resilient supply chains, on the other hand, offer a more flexible response because they can produce critical supplies during a crisis.<sup>38</sup>

<sup>31</sup> *Japan Reveals 87 Companies Eligible for “China Exit” Subsidies*, NIKKEI ASIAN REV. (July 17, 2020).

<sup>32</sup> Geoffrey Gertz has suggested that even with subsidies, firms may struggle to shift supply chains away from China. See also Finbarr Bermingham, *U.S. Firms Want to Ditch China, but Warned “It Is Not Like Flipping a Switch,”* S. CHINA MORNING POST (July 10, 2020).

<sup>33</sup> See, e.g., Consolidated Version of the Treaty on the Functioning of the European Union, Art. 107, Oct. 26, 2012, OJ C 326 (generally prohibiting state aid).

<sup>34</sup> See generally Michael Keen & Kai A. Konrad, *The Theory of International Tax Competition and Coordination*, in 5 HANDBOOK OF PUB. ECON. 257, 311–14 (Alan J. Auerbach, Raj Chetty, Martin Feldstein & Emmanuel Saez eds., 2013).

<sup>35</sup> Agreement on Subsidies and Countervailing Measures, Arts. 2, 5, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 UNTS 14.

<sup>36</sup> Agreement on an International Energy Program, Nov. 18, 1974, 1040 UNTS 271.

<sup>37</sup> Haven Orecchio-Egresitz, *22,000 Surgical Masks Shipped from the National Stockpile to the University of Michigan Were Not Usable*, BUS. INSIDER (Apr. 16, 2020), at <https://www.businessinsider.com/masks-sent-to-u-michigan-from-the-stockpile-not-usable-2020-4> (reporting that the national stockpile has had multiple issues with defective masks).

<sup>38</sup> Governments might also be able to use antidumping or countervailing duties—additional surcharges imposed on “unfairly” cheap (often subsidized) imports—to counteract the supply chain risks posed by other nations’ subsidies, as a group of former EU trade officials recently proposed. See Mogens Peter Carl, Riccardo Perissich, John Bruton Karl Falkenberg, Michel Servoz, Pierre Defraigne, et al., *EU Open Letter to the European Commission 12 May 2020*, POLITICO (May 12, 2020). But while a variety of proposals have been floated to expand the use of antidumping and countervailing duties to respond to a broader range of policy problems,



Given the limitations of spending-based measures, democracies in particular are more likely to address supply chain risks, at least in part, through regulations. Again, WTO rules pose few problems for certain classes of regulations. For instance, the government can collect information from firms about their supply chains and require the publication of that information.<sup>39</sup> But regulations that require more—especially those that privilege products from particular countries as a means of promoting reshoring or supply chain diversification, or regulations aimed at breaking the monopoly power of foreign suppliers—may be vulnerable under WTO rules. A number of WTO rules on regulation, such as Article 2.2 of the Technical Barriers to Trade Agreement, require that regulations “shall not be more trade-restrictive than necessary. . . .”<sup>40</sup> Regulations related to food—a supply chain that the COVID-19 pandemic has put under stress—are vulnerable to challenge on the basis that they do not have a scientific basis.<sup>41</sup> Whether mitigating supply chains risks counts as a legitimate justification under these rules is unclear.

Nondiscrimination rules can also present problems for regulations that arguably have adverse trade effects.<sup>42</sup> Such rules ostensibly allow governments to adopt any policy as long as it does not treat imports less favorably than either other domestic products (“national treatment”) or products from other countries (“most-favored nation”). Regulations designed to encourage the development of local supply chains, such as local content requirements, are among the most vulnerable to challenges that they are unlawfully discriminatory.<sup>43</sup> Even regulations designed to promote global diversification of supply chains could potentially violate most-favored nation rules if they favor products from some WTO members (say, Canada or the EU) over others (say, China).<sup>44</sup> Yet, these regulations can be both an effective part of a strategy to address supply chain risks and more politically feasible than straight production subsidies.<sup>45</sup>

Government measures that encourage supply chain diversification by promoting competition are also vulnerable under WTO rules. Russia, for example, challenged the EU’s

WTO panels have generally taken a dim view of expansive uses of these duties. See Gregory Shaffer, *Retooling Trade Agreements for Social Inclusion*, 2019 U. ILL. L. REV. 1 (2019); Timothy Meyer & Ganesh Sitaraman, *A Blueprint for a New American Trade Policy*, THE GREAT DEMOCRACY INITIATIVE (2018).

<sup>39</sup> Geoffrey Gertz, *The Coronavirus Will Reveal Hidden Vulnerabilities in Complex Global Supply Chains*, BROOKINGS INST. (Mar. 5, 2020), at <https://www.brookings.edu/blog/future-development/2020/03/05/the-coronavirus-will-reveal-hidden-vulnerabilities-in-complex-global-supply-chains>.

<sup>40</sup> See, e.g., Todd Tucker, *WTO Tobacco Industry Ruling Marks End of an Era*, MEDIUM (June 24, 2020), at <https://medium.com/@toddtucker/wto-tobacco-industry-ruling-marks-end-of-an-era-2df6ee3d618>.

<sup>41</sup> Agreement on the Application of Sanitary and Phytosanitary Measures, Art. 5, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 UNTS 493; see also Simon Lester, *Food Regulation, Science, Protectionism, and Regulatory Autonomy/Sovereignty*, INT’L ECON. L. & POL’Y BLOG (June 22, 2020), at <https://ielp.worldtradelaw.net/2020/06/food-regulation-science-and-trade-policy.html>.

<sup>42</sup> Appellate Body Report, United States—Measures Affecting the Production and Sale of Clove Cigarettes, para. 71, WTO Doc. WT/DS406/AB/R (adopted Apr. 24, 2012).

<sup>43</sup> Although localization regulations can take a number of different forms, the classic form, a local content requirement, clearly violates GATT Article III’s national treatment rule. See, e.g., Appellate Body Report, Canada—Certain Measures Affecting the Renewable Energy Generation Sector, para. 6.1.b, WTO Doc. WT/DS412/AB/R (adopted May 24, 2013); Appellate Body Report, India—Certain Measures Relating to Solar Cells and Solar Modules, para. 6.2.a, WTO Doc. WT/DS456/AB/R (adopted Sept. 16, 2016) [hereinafter India Appellate Body Report].

<sup>44</sup> Such measures could violate the most-favored nation obligation. See GATT, *supra* note 23, Art. I.

<sup>45</sup> See Timothy Meyer, *How Local Discrimination Can Promote Global Public Goods*, 95 BOSTON U. L. REV. 1939 (2015).

so-called “Third Energy Package,” which sought to regulate the EU’s energy supply chain in a variety of ways designed, in large part, to decrease the EU’s dependence on natural gas supplies from Russia. While the EU prevailed against many of Russia’s claims, Russia won a challenge to a regulation that sought to increase competition by limiting the pipeline access that Gazprom, a Russian gas monopoly, would enjoy. Although the panel recognized that the regulation was designed to combat a condition of monopoly created by the Russian government, the panel nevertheless ruled against the EU, reasoning that only the legality of the EU’s measures was properly before it.<sup>46</sup>

### B. *The Exceptions*

Regulations that address supply chain risks, especially those that do so by promoting the location of supply chains in some countries but not others, are therefore vulnerable under WTO rules. As a result, states will have to rely on exceptions to those rules to justify aggressive preventative measures. Unfortunately, though, WTO rules only provide that kind of flexibility during a crisis.<sup>47</sup>

For instance, GATT Article XI generally bans export restrictions. It contains a carveout, however, for “[e]xport prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party.”<sup>48</sup> The WTO’s Appellate Body has said that a measure is “temporarily applied” when it is applied “for a limited time” or “to bridge a ‘passing need.’”<sup>49</sup> This requirement alone renders Article XI’s carveout of limited value as a means of incentivizing firms to plan for supply chain disruptions. Moreover, the Appellate Body defined a “critical shortage” as “those deficiencies in quantity that are crucial, that amount to a situation of decisive importance, or that reach a vitally important or decisive stage, or a turning point.”<sup>50</sup> Preventative measures will be designed to avoid reaching this kind of critical stage, thus rendering Article XI:2(a)’s carveout of minimal use.

GATT Article XX also contains a number of exceptions that can conceivably justify trade restrictions imposed in response to a supply chain crisis, but it offers little assistance in justifying preventative measures. Most directly, Article XX(j) provides an exception for measures:

<sup>46</sup> The panel found the measure violated GATT Article XI, which bans prohibitions on imports or exports. A related component of the EU’s measure failed under the GATT’s national treatment rule. See Panel Report, European Union and its Member States—Certain Measures Relating to the Energy Sector, paras. 7.974–7.975, 7.1002–7.1003, WTO Doc. WT/DS476/R (adopted Oct. 8, 2018) [hereinafter EU Energy Panel Report].

<sup>47</sup> Elsewhere in this Agora, Julian Arato, Kathleen Claussen, and J. Benton Heath make an argument similar to mine: that the need to resort to these exceptions exposes a structural weakness in international economic law. Julian Arato, Kathleen Claussen & J. Benton Heath, *The Perils of Pandemic Exceptionalism*, 114 AJIL 627 (2020). Alan Sykes, by contrast, argues that these exceptions operate as an escape clause during stressful times. Alan O. Sykes, *Short Supply Conditions and the Law of International Trade: Economic Lessons from the Pandemic*, 114 AJIL 647 (2020).

<sup>48</sup> GATT, *supra* note 23, Art. XI(2)(a). A carveout is formally different from an exception, in that the complaining party bears the burden of showing that carveout does not apply. See Joost Pauwelyn, *Export Restrictions in Times of Pandemic: Options and Limits Under International Trade Agreements*, in COVID-19 AND TRADE POLICY, *supra* note 9 (listing carveouts and exceptions for export restrictions).

<sup>49</sup> China Appellate Body Report, *supra* note 22, paras. 323, 344.

<sup>50</sup> *Id.*, para. 324.



essential to the acquisition or distribution of products in general or local short supply; Provided that . . . any such measures, which are inconsistent with the other provisions of the Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist.<sup>51</sup>

By its terms, Article XX(j) applies only when and for so long as an actual shortage exists.<sup>52</sup> Thus, measures to promote supply chain resilience in advance of a shortage could not be justified under Article XX(j).

Article XX(b) provides an exception for measures “necessary to protect human, animal, or plant life or health.” The scope of Article XX(b) would seem to fit preventative measures designed to protect supply chains, at least insofar as those supply chains relate to a health crisis. The requirement that measures be “necessary,” however, imposes a more substantial hurdle. “Necessity” generally requires balancing the trade restrictiveness of a measure against the degree to which a measure contributes to its purpose, in light of the values being protected.<sup>53</sup> Health measures have generally fared well under this analysis, with the Appellate Body confirming the preeminent importance of human health measures.<sup>54</sup> But the absence of an imminent threat may make it harder to demonstrate that measures aimed at protecting health through protecting supply chains actually contribute to health. This showing becomes harder the more trade restrictive the challenged measure is.<sup>55</sup>

Finally, Article XXI provides an exception for national security measures. In relevant part, Article XXI(b) excuses conduct a member state takes “which it considers necessary for the protection of its essential security interests . . . taken in time of war or other emergency in international relations.”<sup>56</sup> A recently adopted WTO panel report concluded that it could judge, from an objective point of view, whether such an emergency exists.<sup>57</sup> But it also concluded that an “emergency” is limited “to a situation of armed conflict, or of latent armed conflict, or of heightened tension or crisis, or of general instability engulfing or surrounding a state.”<sup>58</sup> At a minimum, then, the exception would appear limited to measures that respond to an existing crisis, rather than measures aimed at heading off a future one.

<sup>51</sup> GATT, *supra* note 23, Art. XX(j).

<sup>52</sup> India Appellate Body Report, *supra* note 43, para. 5.70 (“We read this language in Article XX(j) to contemplate situations of ‘short supply’ that may continue over time, but are nonetheless expected not to last indefinitely.”); *see also* EU Energy Panel Report, *supra* note 46, para. 7.1348 (interpreting Article XX(j) not to apply to products “currently not in short supply but that may become”).

<sup>53</sup> Appellate Body Report, Brazil—Measures Affecting Imports of Retreaded Tyres, para. 156, WTO Doc. WT/DS332/AB/R (*adopted* Dec. 17, 2007).

<sup>54</sup> *Id.*, para. 179 (“[T]he objective of protecting human life and health against such diseases ‘is both vital and important in the highest degree.’”).

<sup>55</sup> Review for unjustifiable or arbitrary discrimination under the chapeau of Article XX has also posed a significant hurdle for governments.

<sup>56</sup> *See* GATT, *supra* note 23, Art. XXI(b)(i)–(ii) (Art. XXI(b) also contains exceptions that would cover nuclear and military supply chains).

<sup>57</sup> Panel Report, Russia—Measures Concerning Traffic in Transit, para. 7.77, WT/DS512/R (*adopted* Apr. 5, 2019).

<sup>58</sup> *Id.*, para. 7.76. A second panel, interpreting Article 73(b)(iii) of the Agreement on Trade-Related Aspects of Intellectual Property—which is identical to GATT Article XXI(b)(iii)—reached a similar conclusion. *See* Panel Report, Saudi Arabia—Measures Concerning the Protection of Intellectual Property Rights, paras. 7.241 et seq., WT/DS567/R (*circulated* June 16, 2020).

## IV. REFORMING TRADE LAW TO ALLOW SUPPLY CHAIN REGULATION

Trade liberalization has been one of the greatest forces for good in the last century—helping to preserve and promote global peace and security, lifting millions out of poverty, and spurring economic development around the world—and the GATT/WTO can rightfully be considered among the most effective international organizations ever created. But no institution nor any specific set of multilateral rules is sacred. Policies and institutions must fit the moment.

As the COVID-19 pandemic has made clear, the concentration of some critical supply chains in a few countries has left developed countries vulnerable to supply shocks during times of crisis. Trade rules limit the options available to governments to regulate preventatively. In so doing, they encourage states to wait for a crisis before acting to head off supply chain risks. Such delays risk magnifying both the severity and frequency of crises and, as Arato, Claussen, and Heath argue, put stress on the international economic law system as a whole.<sup>59</sup> A course correction is needed to avoid such bad incentives, and to make global trading rules fit modern trading challenges.

A comprehensive analysis of how governments might reform trade agreements is beyond the scope of this Essay. But simply correcting the deficiencies identified in this Essay would be a good start. FTAs should have strong rules of origin that incentivize production within the free trade area. Absent such rules, FTAs do not serve their foreign policy functions and can exacerbate the concentration of critical supply chains overseas. Member states must also reconsider how trade rules provide policy space for states to manage supply chain risks. A system that forecloses aggressive preventative regulation of supply chain risks in favor of crisis management is a system that courts more crises.

In this sense, trade law is at a similar juncture as rules on the use of force were two decades ago. Like trade law, the prohibition on the use of force contains an exception for measures necessary to respond to an imminent threat. And like trade law, that exception came under stress because major powers, notably the United States, felt that, strictly interpreted, it overly limited their ability to take preventative action.<sup>60</sup> Without a negotiated resolution, the United States stretched the imminence requirement in ways that prompted sharp dissent from other nations and have had lasting, and unintended, consequences. Of course, a broader discussion on WTO reform is under way. But absent a negotiated resolution to insulate aggressive preventative regulation of supply chains from challenge, trade rules and their exceptions face a similar fate in the post-COVID-19 world.

<sup>59</sup> Arato, Claussen & Heath, *supra* note 47.

<sup>60</sup> See, e.g., Ashley S. Deeks, “Unwilling or Unable”: *Toward a Normative Framework for Extra-territorial Self-Defense*, 52 *VIRG. J. INT’L L.* 483, 492 & n. 23 (2011) (reviewing literature on what constitutes an “imminent” threat).