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# Fairtrade City Subsidization and WTO Agreement Violations

by David Collins\*

## **I) Introduction**

Fairtrade is a product designation which denotes that a good's original producers have obtained a minimum price that allows for their healthy living conditions and re-investment into sustainable production. In the UK and many other developed countries, Fairtrade appears as a consumer label on products indicating that the goods conform to this production standard. Sellers of the goods in the UK are granted licenses by the Fairtrade Labelling Organizations International ('FLO'), a private body partially funded by the European Commission, so that sellers can display the Fairtrade logo in conjunction with their products, which are sourced from producers whose working conditions and income levels conform to the organization's standards. Currently FLO has certified more than one million producers worldwide in 58 developing countries located in Africa, Asia and Latin America.<sup>1</sup> In the UK the most common Fairtrade products are commodities such as coffee and bananas, although some firms sell products as diverse as Fairtrade clothing and jewellery. Although even proponents of Fairtrade acknowledge that it may harm producers in developing countries because of stimulating over-supply ultimately leading to price reductions in commodities such as coffee<sup>2</sup>, it enjoys wide popularity among consumers in prosperous nations who are willing to pay more for products because of the conditions in which they are produced. Sales of Fairtrade goods in the UK, the world's leading

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<sup>1</sup> <www.fairtrade.net> (June 2006)

<sup>2</sup> J Draeger "Perking Up the Coffee Industry Through Fair Trade" 11 Minnesota Journal of Global Trade 337 (2002) at 368

Fairtrade market, amounted to £195 m in 2005<sup>3</sup> and have become a prominent feature of 21<sup>st</sup> century “ethical consumerism”, which as Andrew Fagan explains “offers the promise of transforming consumption ... into a means for enhancing rather than restricting human rights.”<sup>4</sup>

The aims of Fairtrade are undeniably laudable and its effects are probably beneficial to some, but the legality of Fairtrade in the context of international trade regulation is far from certain. That Fairtrade has largely escaped academic commentary has been explained by its informality – it is seen as a cultural rather than an economic activity.<sup>5</sup> This brief article will consider one aspect of Fairtrade that is identifiably formal and of questionable legitimacy: the existence of local government policies in the UK that assist Fairtrade licensed goods and in so doing hinder sales of the non-Fairtrade goods with which they compete. These policies fall foul of World Trade Organization (WTO) agreements which ensure that like products are treated in a non-discriminatory manner irrespective of their country of origin. Specifically, this article will argue that the Fairtrade City program is an illegal subsidization that amounts to *de facto* discrimination by country of origin, a clear violation of the General Agreement on Tariffs and Trade, 1994 (‘GATT’, incorporating the text of GATT, 1947) Most Favoured Nation principle<sup>6</sup> (MFN). Potential WTO violations involving labelling and government procurement will also be considered briefly. We will begin by outlining the Fairtrade City regime.

## **B) Fairtrade Cities**

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<sup>3</sup> <[http://www.fairtrade.org.uk/about\\_sales.htm](http://www.fairtrade.org.uk/about_sales.htm)> (June 2006)

<sup>4</sup> “Buying Right: Consuming Ethically and Human Rights” in J Dine and A Fagan eds. *Human Rights and Capitalism: A Multidisciplinary Perspective on Globalization* (Edward Elgar Publishing, Cheltenham, 2006) at 115.

<sup>5</sup> A Groos “International Trade and Development: Exploring the Impact of Fair Trade Organizations in the Global Economy and the Law” 34 *Texas International Law Journal* 379 (1999) at 401.

<sup>6</sup> GATT 1947, Article I

In order to become designated as a Fairtrade City the Fairtrade Foundation requires that the town council of a candidate city support local Fairtrade industry in the following five ways:

1. The local council must pass a resolution supporting Fairtrade, and serve Fairtrade coffee and tea at its meetings and in offices and canteens.
2. A range of Fairtrade products must be readily available in the area's shops and served in local cafés and catering establishments (targets are set in relation to population).
3. Fairtrade products must be used by a number of local work places (estate agents, hairdressers etc) and community organisations (churches, schools etc).
4. The council must attract popular support for the campaign.
5. A local Fairtrade steering group must be convened to ensure continued commitment to Fairtrade City status.<sup>7</sup>

United Kingdom cities which have adopted these policies and have achieved the designation include Leeds, Edinburgh, Southampton, Newcastle, York, and more than twenty smaller boroughs, including some in London. Although the economic impact of such measures may ultimately be limited because of the small number of Fairtrade products sold relative to equivalent goods in general, the policies violate the WTO's Agreement on Subsidies and Countervailing Measures ('ASCM'). Through the Fairtrade City regime, local governments have adopted a policy by which goods of a certain origin (ostensibly meaning produced in a certain manner but by necessary implication also meaning from certain countries) are placed at an advantage relative to goods from other international producers (as well as local producers) who are not Fairtrade certified. This amounts to *de facto* discrimination that is oddly *against* like

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<sup>7</sup> As taken from the "Fairtrade in Leeds" website <<http://www.fairtradeleeds.org/fairtradecity.htm>>

domestic products<sup>8</sup> but more importantly, among different nations, breaching MFN obligations.

### **C) Fairtrade City policies as Actionable Subsidies**

Fairtrade City policies which favour imported goods from Fairtrade producers may have the effect of reducing the sale of imports of similar goods from non-Fairtrade sources. This situation is encompassed by the GATT<sup>9</sup> requirement that any ‘subsidy’ by a Member (of the WTO) that has the effect of reducing imports into that Member’s territory requires notification to all Contracting Parties of the extent of the subsidy and if serious prejudice has resulted to another Member, then consultations should occur with the objective of limiting the subsidy. The Agreement on Subsidies and Countervailing Measures (‘ASCM’) outlines the definition of a subsidy:

For the purpose of this Agreement, a subsidy shall be deemed to exist if:

- (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
  - (iii) a government provides goods or services other than general infrastructure, or purchases goods;  
and
- (b) a benefit is thereby conferred.<sup>10</sup>

As public bodies, Fairtrade Cities violate this provision in two ways. First, the government provides the service of marketing Fairtrade goods through ‘the attraction of popular support’ including in some cities posters, newsletters or the preparation and distribution of a list of Fairtrade goods providers.<sup>11</sup> This free advertising, which is

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<sup>8</sup> Which is counterintuitive to the National Treatment prohibition imposed by GATT Article III

<sup>9</sup> Article XVI

<sup>10</sup> Article 1.1

<sup>11</sup> See eg Fairtrade Newcastle website above note 6 and Fairtrade Hull website: <<https://www.fairtradehull.org.uk>> (June 2006)

not extended to non-Fairtrade goods, amounts to a significant cost saving for Fairtrade producers and therefore is an indirect 'benefit'. Second, local councils purchase Fairtrade goods, as seen in the policy on serving coffee and tea at council meetings and on council premises. The requirement that Fairtrade products be used by other community organizations such as churches contributes to this benefit, as more Fairtrade goods are sold resulting in more profit to the retailers and producers irrespective of objective criteria such as price or quality of their wares. We can infer that without the trade distorting effects of this subsidy, non-Fairtrade goods in the UK would be able to compete equally with Fairtrade goods.

These subsidies would likely not fall into the 'Prohibited' classification because they are not contingent on export performance nor upon the use of domestic over imported goods. However, Fairtrade City subsidies may be 'Actionable.' This designation requires the subsidy's characterization as 'specific' as defined by the ASCM<sup>12</sup> which states that 'where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.'<sup>13</sup> Fairtrade City policies provide the abovementioned subsidies only to enterprises that are licensed by the Fairtrade mark. All enterprises are not 'automatically eligible'<sup>14</sup> because they must meet certain standards of production imposed by the FLO, one of which is that the imported goods must originate in developing countries. Fairtrade City subsidies are therefore specific and Actionable.

Actionable subsidies as specified by the ASCM are subsidies which lead to 'adverse effects' of another Member. Adverse effects can consist either of 'injury to the domestic industry of another member'; 'nullification or impairment of benefits

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<sup>12</sup> Article 2.1

<sup>13</sup> Article 2.1 a)

<sup>14</sup> Article 2.1 b)

accruing directly or indirectly to other Members’; or ‘serious prejudice to the interests of another member.’<sup>15</sup> The ASCM elaborates that serious prejudice includes situations where the effect of the subsidy is ‘to displace or impede the imports of a like product of another Member into the market of the subsidizing Member’<sup>16</sup> or also if there are ‘lost sales in the same market.’<sup>17</sup> It must therefore be shown that non-Fairtrade firms were selling the same goods and second, that sales had decreased because of the local council’s assistance to Fairtrade goods. The words ‘another’ and ‘other’ indicate that the provision on specificity is concerned with MFN: damage done to other producers in other countries that have not been certified and whose sales in the UK suffer as a consequence. Thus, for example, the United States would need to show that sales of its cotton in the UK were diminished because of Fairtrade City policies advocating the purchase of Fairtrade cotton from India. Whether a situation like this has actually occurred would require further research, but there is clearly a perception of injury based upon unequal treatment.

The ASCM’s provisions on Actionable Subsidies do not apply to measures assisting agricultural products because the Agreement on Agriculture establishes that domestic support for agriculture is deemed non-Actionable and exempt from remedial action.<sup>18</sup> However the Agricultural Agreement’s use of the word ‘domestic’ implies that this exception was meant to cover situations where a Member’s subsidies assisted its own producers (as normal for a subsidy), not situations such as Fairtrade Cities where subsidies assist producers, seemingly counter-intuitively, from other Member states. Secondly, even if the Agricultural Agreement does exempt Fairtrade City

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<sup>15</sup> Article 5

<sup>16</sup> Article 6.3 a)

<sup>17</sup> Article 6.3 c)

<sup>18</sup> Article 13

subsidies, it does so only for agricultural products and not Fairtrade goods such as jewellery or clothing, which are becoming increasingly popular.

#### **D) Remedies**

As Actionable Subsidies, Fairtrade City policies allow for international challenge under the WTO dispute settlement mechanism<sup>19</sup> and the imposition of Countervailing Duties under national law<sup>20</sup> provided that a causal link is established between the subsidy and the calculable injury.<sup>21</sup> As suggested above, Fairtrade City policies which discriminate by production method (ie. disadvantaged sources) amount to a *de facto* violation of MFN: the Fairtrade designation is not available to producers from all Members, but only those in the developing world – goods from some Members are treated preferentially relative to others. Thus a Member which has no Fairtrade certified producers, such as Canada, might launch a complaint through the WTO Dispute Settlement Body ('DSB') against the EU because Canada's exports of certain goods to the UK are disadvantaged relative to goods from other Members which produce equivalent Fairtrade certified goods. The discrimination is rooted in the failure of the FLO to certify goods exported from developed nations. Consumers may assume that all goods produced within an economically strong nation are done so by people who are earning a fair wage and living well, but this disregards disadvantages suffered by particular regions or groups within those nations. The moral (if not the economic) justification for Fairtrade could be extended to impoverished producers such as North American aboriginals, but it is doubtful that goods from these sources would ever be Fairtrade certified because of the FLO's focus on the developing world.

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<sup>19</sup> ASCM Article 7

<sup>20</sup> GATT Article VI

<sup>21</sup> As required by Article 10-23 of the ASCM

The remedies available to a Member state which has been injured or whose benefits have been nullified or impaired due to Fairtrade City policies would be first to request consultation under the ASCM.<sup>22</sup> Such consultations would aim at achieving a ‘mutually agreed solution’<sup>23</sup> to the discrimination. If this stage is not fruitful then the formal Dispute Settlement Process would be engaged and were a Panel to find that subsidization had in fact caused injury then the subsidizing member would be required to ‘take appropriate steps to remove the adverse effect or ... withdraw the subsidy.’<sup>24</sup> The remedy with the sharpest teeth, Countervailing Measures, appears to be unavailable to a Member injured by Fairtrade City policies because the ASCM speaks of this remedy in conjunction with domestic injuries resulting from subsidized *imports*<sup>25</sup> which does not apply to Fairtrade City assistance to goods sold within the UK, the effect of which is exclusively related to the reduction of sales for certain foreign goods. For example Japan could not impose duties on imported Fairtrade products from Members whose goods have been subsidized in the UK as the result of Fairtrade City measures.

#### **E) Exceptions for Developing Country Assistance and General Exceptions**

The WTO regime contains numerous provisions to assist developing country Members. Among the most significant of these is Part IV of GATT which requires that developed countries shall grant ‘more favourable and acceptable conditions of access to world markets’<sup>26</sup> for products from the developing world and ‘give active consideration to the adoption of other measures [other than reduced tariffs] designed to provide greater scope for the development of imports from less developed

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<sup>22</sup> Article 7.1

<sup>23</sup> Article 7.3 ASCM

<sup>24</sup> ASCM Article 7.8

<sup>25</sup> ASCM Articles 10 and 11.2

<sup>26</sup> GATT Article XXXVI.4

contracting parties.’<sup>27</sup> Part IV of GATT was elaborated upon in the CONTRACTING PARTIES: Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries decision.<sup>28</sup> This allows WTO Members to accord more favourable treatment to developing countries as a departure from the Most Favoured Nation principle. The broad language of ‘other measures’ from GATT IV and ‘special treatment’<sup>29</sup> from the CONTRACTING PARTIES decision may permit such actions as are seen in Fairtrade City regimes to assist the performance of goods from the developing world. However such advantageous treatment is subject to the requirement that no ‘undue difficulties’ are suffered by other contracting parties.<sup>30</sup> It might be difficult to argue that marketing assistance for Fairtrade goods amounts to an undue difficulty for non-Fairtrade goods, but a policy which prohibits outright both the sale of non-Fairtrade coffee on government premises or the use of non-Fairtrade coffee at government meetings might seem to do so. The flexibility of the concept of ‘undue difficulty’ would seem to grant a developed Member which supplies non-Fairtrade goods ample room to require consultations with Members imposing the measure as permitted within the CONTRACTING PARTIES decision.<sup>31</sup>

Moreover, it is unlikely that developing country exceptions would exempt Fairtrade City policies from strict GATT adherence for two reasons. First, it must be acknowledged that much of the benefit that local councils bestow upon Fairtrade goods is enjoyed by retailers in the developed world who use the Fairtrade label as a promotional tool. Policies which assist these firms should accordingly not fall under the umbrella of protection afforded by developing world concessions. Second, it is

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<sup>27</sup> Article XXXVII.3b.

<sup>28</sup> L/4903 (28 November 1979) [hereinafter CONTRACTING PARTIES]

<sup>29</sup> Section 2 d.

<sup>30</sup> Section 3 a.

<sup>31</sup> Section 4 b.

uncertain that Fairtrade as a philosophy is truly in-line with the WTO's goal of long term market advancement of economically weak countries. Rather, Fairtrade policies encourage destructive dependence by the developing world upon primary goods that cannot ensure these nations' long-term economic prosperity. While noting that market access for these primary goods should be fostered the Part IV of GATT also provides:

The rapid expansion of the economies of the less-developed contracting parties will be facilitated by a diversification of the structure of their economies and the avoidance of an excessive dependence on the export of primary products.<sup>32</sup>

This should operate as an overarching principle through which all WTO agreements are interpreted. Fairtrade's devotion to goods such as coffee and textiles, which may help certain small suppliers in the short term, may damage the economies of developing nations by inhibiting market expansion into sectors that will ultimately yield higher income and provide greater stability, such as manufactured goods. Thus, until it can be empirically established that Fairtrade is actually helping the economies of disadvantaged nations on a macroeconomic scale, GATT violative Fairtrade City policies should not be saved by the WTO's exemptions for assistance to developing country members.

It appears unlikely that the General Exceptions to GATT under Article XX would afford protection to Fairtrade City violations. The most likely of the enumerated grounds which would cover Fairtrade City regulations are probably the protection of public morals<sup>33</sup> or the protection of human life or health.<sup>34</sup> It is difficult to envision that the altruistic promotion of a foreign nation's economy could be viewed as an aspect of morality in the sense that it affects British society in a tangible way. The poor living conditions among producers in developing countries is

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<sup>32</sup> Article XXXVI.5

<sup>33</sup> Article XX a

<sup>34</sup> Article XX b

conceivably a matter of human health but only in the worst cases where disease or famine has resulted from low income. Fairtrade goods do not yet appear to have been sourced from prison labour such that subsection e) would not apply. It is possible that Fairtrade goods such as coffee might fit within exceptions for intergovernmental commodity agreements<sup>35</sup> but this would offer no justification for goods such as jewellery or hand crafts. In noting that it is unclear which of the General Exceptions would apply to Fairtrade programs, Carlos Lopez-Hurtado observes that ‘the limited number of social policies enumerated in Article XX restricts the potential of that provision as a justification for social labelling regulations that are otherwise inconsistent with substantive provisions of the GATT.’<sup>36</sup> Even if one of these categories could be stretched to encompass Fairtrade, these exceptions would still be subject to the chapeau of Article XX which prohibits arbitrary or unjustifiable discrimination between countries where the ‘same conditions prevail.’ As suggested above, poor living standards exist within in the developed world yet these nations are excluded from the Fairtrade regime such that the General Exceptions could not apply.

## **F) Labelling**

Article IX of the GATT asserts that any labelling requirements imposed by Members should be as minimal as possible and done on a MFN basis. Accordingly any differentiation among ‘like’ products based on their source through marks of origin – as in Fairtrade City labelling – would seem to be illegal from a WTO perspective.

However in *US Import Restrictions on Tuna*<sup>37</sup>, a GATT panel found that voluntary

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<sup>35</sup> Article XX h. A discussion of the International Coffee Agreement is beyond the scope of this article. See Draeger above note 2 and M Foli ‘International Coffee Agreements and the Elusive Goal of Price Stability’ 4 *Minn J of Global Trade* 79 (1995).

<sup>36</sup> C Lopez-Hurtado “Social Labelling and WTO Law” 5 *Journal of International Economic Law* 719 at 732.

<sup>37</sup> 31 ILM 1991 pp 1598-623 (unadopted) [hereinafter *Tuna I*].

labelling schemes which restrict sales based on consumer choice (in that case labelling tuna ‘Dolphin Safe’) did not violate the MFN requirement of Article IX because they applied to all countries who caught tuna in a particular part of the ocean and therefore did not distinguish between country of origin. It is unclear whether such a ruling could be extended to Fairtrade labelling because advantages engendered by Fairtrade City measures are not strictly the result of consumer preference but a government choice to make a particular type of product more accessible to consumers primarily through advertising. Moreover, as we have seen, Fairtrade does indirectly distinguish between country of origin as it is a label which is only available to producers in the developing world.

There should be some concern that voluntary social labels such as Fairtrade are based upon a good’s process or production method (PPM) rather than on the characteristics of the product itself. However it is unclear whether regulations governing PPMs (such as labour standards) can be challenged under the substantive provisions of the GATT or under the Code of Standards of the Agreement on Technical Barriers to Trade.<sup>38</sup> Under the latter agreement, any regulation must not constitute an ‘un-necessary obstacle to trade.’ Carlos Lopez-Hurtado argues that even if labels that denote PPMs are subject to the TBT Agreement ‘an origin neutral label that works primarily as a market tool to inform and coordinate consumer preferences is one of the least restrictive mechanisms one could possibly imagine.’<sup>39</sup> Still, Fairtrade City programs involve more than merely promoting the adoption of labels but provide free advertising and government purchasing which may transgress the as yet undefined concept of ‘reasonable measures’ under the TBT.

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<sup>38</sup> Lopez-Hurtado contrasting *Tuna I* and *Korea-Measures Affecting Imports of Fresh, Chilled and Frozen Beef* AB WT/DS161/AB/R (10 Jan 2001), above note 36 at 735-736.

<sup>39</sup> Referring to government policies in Belgium similar to those of Fairtrade City, *ibid* at 742.

## **G) Government Procurement**

Currently one expectation of becoming a Fairtrade city is the 'lawful' exploration of procurement from Fairtrade sources.<sup>40</sup> As Fairtrade City policies are the result of actions by government bodies, an obvious issue raised is the WTO's plurilateral Government Procurement Agreement which requires transparency and non-discrimination in government purchasing (including purchasing by most local governments) from international suppliers.<sup>41</sup> However it is unlikely that small local council purchases like coffee for meetings would meet the relatively high monetary thresholds of the GPA such that the agreement's MFN obligations would not be engaged. Still, should larger government agencies in the UK choose to adopt Fairtrade City type policies in the future involving more costly procurement, for example Fairtrade clothing for postal workers uniforms, then the open tendering processes mandated by the GPA would have to be observed, unless that agreements' exceptions for developing country suppliers were to apply to Fairtrade goods.

## **H) Conclusion**

The extent of the injury sustained by non-Fairtrade producers at the hands of Fairtrade Cities might well be negligible given the relatively small quantity of goods sold in small Fairtrade shops throughout the UK. Perhaps a more serious problem is the perception of unfairness engendered by local governments' favouritism towards certain goods that is clearly antithetical to the principles of free trade encapsulated by the WTO. Absent a quantifiable injury, the identification of which would require additional investigation, the formal Dispute Settlement mechanism of the WTO would be difficult to engage and therefore consultations through the WTO forum may be the

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<sup>40</sup> "Fairtrade Newcastle" <<http://www.newcastle.gov.uk/fairtrade.nsf/a/newcastle>> (June 2006). Note that the lawfulness of the other requirements seems to be irrelevant.

<sup>41</sup> Government Procurement Agreement, Article III

best recourse for injured Members. Rather than wait for this to be done, local councils in the UK should take the initiative to abandon discriminatory Fairtrade City policies not only because these measures transgress the spirit and letter of the WTO agreements, but also because it is beyond the authority of any elected government to assist with the marketing of selective businesses without sound economic justification.