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EU-Ukraine Arbitration on the Export of Wood: Will Protectionism Prevail?

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On 28 January 2020, the arbitration panel has been formed in the dispute between the EU and Ukraine regarding Ukraine's export prohibition of unprocessed timber. Notably, this is the first dispute between the EU and Ukraine under the Association Agreement ("**EU-Ukraine AA**"), and here, the EU invokes the dispute settlement mechanism provided by the free-trade agreement instead of the usual WTO dispute settlement mechanism.

Background of the Dispute

In brief, on 20 June 2019, the European Union initiated arbitration against Ukraine under Article 306 of the EU-Ukraine AA between the European Union and Ukraine regarding Ukraine's export prohibition of unprocessed timber.

The dispute arose when Ukraine imposed a temporary 10-year ban on export of unprocessed timber by the Law of Ukraine No 325-VIII of 9 April 2015. The law imposed a ban on the export of all timber except the pine tree as of 1 November 2015, and as of 1 January 2017 of the pine tree as well. The Explanatory Note to the law clarified that the main objective of this law is reorientation of the export from the unprocessed timber to the furniture products and processed timber. The note reasons that the export of the unprocessed timber that is of low value itself comparing to the processed timber is neither economically nor ecologically beneficial for Ukraine.

The EU alleges that this export ban contradicts Article 35 of the AA that provides a prohibition on export restrictions by the parties or measures of the equivalent effect.

The dispute settlement mechanism between the EU and Ukraine is stipulated in the EU-Ukraine AA and Articles 306-316 thereto provide for an *ad hoc* arbitration. The dispute is to be resolved by three arbitrators selected as a result of mutual consultations of the parties. The arbitration panel is to render its ruling within 120 days (in certain circumstances no later than 150 days) from the date of its establishment. Article 311 of the EU-Ukraine AA provides an obligation of the parties to comply in good faith with the arbitration panel ruling.

If the respondent fails to comply with the ruling, the complainant may request the respondent to present an offer for temporary compensation (Article 315(1)). If parties cannot reach an agreement on the compensation, the complainant is entitled to "suspend its obligations arising from any

provision contained in the Chapter on the free-trade area at a level equivalent to the nullification or impairment caused by the violation" (Article 315(2)). One of the options for the complainant is to increase the tariff rates to the level applied to other WTO Members.

The arbitration panel, in this case, consists of Christian Häberli (Switzerland / Chairperson), Giorgio Sacerdoti (EU), Victor Muravyov (Ukraine).

Ukraine's Potential Defences

As already noted, the EU alleges breach of Article 35 of EU-Ukraine AA. However, Article 35 of EU-Ukraine AA incorporates Article XI of the General Agreement on Tariffs and Trade 1994 ("**GATT**"). Further, Article 36 of EU-Ukraine AA incorporates exceptions provided for by Article XX and XXI of the GATT 1994 that Ukraine may raise as potential defences.

In particular, Article 35 of the EU-Ukraine AA stipulates exceptions to the prohibition on import/export restrictions by reference to Article XI GATT 1994: "To this end, Article XI of GATT 1994 and its interpretative notes are incorporated into, and made an integral part of, this Agreement".

Article XI:2(a) of the GATT 1994 provides for an exception to the prohibition of the export restrictions when "export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party".

While there should not be many problems proving that unprocessed timber is a product essential to Ukraine, the "critical shortage" criteria of this provision would be difficult to establish. The Appellate Body in *China – Raw Materials* case established that "critical shortage" refers to those deficiencies in the 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 (paragraph 324). And, the Appellate Body upheld the conclusion of the panel that critical shortage criteria would not be satisfied only because of the exhaustibility of the disputed product as in the case of unprocessed timber. The Appellate Body reasoned that "it would seem that Article XI:2(a) measures could be imposed, for example, if a natural disaster caused a "critical shortage" of an exhaustible natural resource, which, at the same time, constituted a foodstuff or other essential product" (paragraph 337). Therefore, the exhaustibility of wood as natural resource *per se* would not be enough for a successful defence under Article XI:2(a) of the GATT 1994.

Further, Article 36 of EU-Ukraine AA incorporates Articles XX and XXI of GATT 1994 that provide for exceptions to the prohibition on import/export restrictions. Article XX of the GATT 1994 sets forth the list of exceptions that may be raised to justify the imposition of export restrictions. Before invoking any exceptions in Article XX, Ukraine must prove that the disputed export restrictions meet the "chapeau test" of Article XX. This test provides that such measures should not be "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". After meeting this test, Ukraine may raise argument under Article XX(g) that provides an exception under which measures relating to the conservation of exhaustible natural resources would not contradict GATT if such measures are made effective in conjunction with restrictions on domestic production or consumption.

The Appellate Body in *China – Rare Earth* clarified that the requirement that restrictions be made effective "in conjunction" suggests that, in their joint operation towards a conservation objective, such restrictions limit not only international trade but must also limit domestic production or consumption (Appellate Body Report, paragraph 5.92). The Appellate Body also made clear that such domestic restrictions must be "real" rather than existing merely "on the books", and there is no requirement that the burden of conservation must be evenly distributed between foreign consumers and domestic producers and consumers (paragraph 5.136). However, at the same time, the Appellate Body noted that "it would be difficult to conceive of a measure that would impose a significantly more onerous burden on foreign consumers or producers and that could still be shown to satisfy all of the requirements of Article XX(g)" (paragraph 5.134). Therefore, the effectiveness of export restrictions for the conservation of the natural resource would be analysed in conjunction with the domestic remedies on the case-by-case basis.

Ukraine, trying to comply with the requirements of this provision, imposed a restriction on domestic consumption of the unprocessed timber in the amount of 25 million m^3 per year. This restriction is imposed under Article 4 of the Law of Ukraine No 2860-IV of 8 September 2005 "On Specifics of the State Regulation of Companies' Activities Related to the Sale and Export of Timber" with specific reference to the Article XX(g) of GATT 1994. This domestic restriction has been introduced only in September 2018 (in comparison to the export ban effective as of November 2015), and the specific reference to the Article XX(g) of GATT 1994 in the wording implies that this, presumably, would be Ukraine's main defence. However, the application of Article XX(g) of GATT 1994 triggers the question whether this domestic restriction is proportionate to the imposed export ban, and why, for instance, the quantitative restriction on the export was not a sufficient remedy. This could be the main stumbling block in Ukraine's defence against the EU's allegations.

Conclusion

To conclude, the argument on conservation of exhaustible natural resource under Article XX(g) of GATT 1994 seems to be most important in Ukraine's defence against the EU's allegations. However, for this argument to work, Ukraine has to prove that the ban was aimed at the conservation of natural resource rather than at boosting national wood processing industry as provides the Explanatory Note. Second, Ukraine must prove the ban was made effective in conjunction with the domestic restrictions. And, although, there is no requirement for even distribution of the burden of conservation, Ukraine should substantiate imposition of more onerous burden on foreign consumers for this argument to stand. Otherwise, the arbitral tribunal is unlikely to uphold Ukraine's protectionist measure.

The evolution of this dispute is especially interesting in the context of criticism towards the export ban which argues that the ban was not effective: it has not ceased the export of unprocessed timber and only triggered the development of the shadow export; the ban does not prevent the deforestation of Ukrainian forests. The outcome of this dispute may shed light on the understanding of whether the protectionism that may be on the rise in view of the current events is ever an effective tool.

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