


The concept of the level playing field in International Economic Law

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ABSTRACT

International economic relations are often compared to a sports game. Within this game, states and private companies compete for influence, market shares, and resources. Competition is unfair when the field has a slope. In keeping with this sports analogy, the ‘game’ of international economic relations depends on a level playing field (LPF). International economic exchange is fair only when this playing field lacks a slope. This article argues that the LPF in international economic law does not require fully equalizing the regulatory burden across market actors, even when incorporating sustainability considerations. Instead, whether regulatory divergences lead to an uneven playing field depends on the nature, intensity, and source of such divergences, and varies on a case-by-case basis. This is important because countries have increasingly introduced LPF measures that seek to achieve comparable regulatory burdens. LPF measures cover a wide range of matters, including environmental and labour standards, subsidies, competition law, and state-owned enterprises.

INTRODUCTION

As the third decade of the twenty-first century begins, the international economic system has transitioned into a phase beyond the Washington Consensus. The past twenty years have seen a challenge, review, and rethinking of the fundamental principles established in the 1990s, such as market liberalization and eliminating trade and investment barriers. Among these shifts, the ‘level playing field’ (LPF) concept has gained prominence in international discourse, particularly in developed countries. This term, associated with sports, conveys that inequalities in economic, labour, and environmental rules governing market participants hinder fairness in international economic relations.

Despite its growing prominence, the exact meaning of LPF remains a subject of ongoing debate. There is no universally accepted definition of what constitutes an LPF or how to translate this metaphor into practical application. This lack of consensus is particularly striking given the increasing use of LPF as a rallying cry in international, national, and regional initiatives.

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The complexity of this issue underscores the challenges and nuances involved in achieving fairness in international economic relations.

Within the ambit of these initiatives, LPF has been associated with harmonization requirements, environmental and labour non-regression obligations, subsidies and state-owned enterprises (SOEs) regulation, and extra-territorial regulation of activities, such as the illicit timber trade. Moreover, interest has grown in LPF strategies that aim to counteract regulatory differences through pricing mechanisms beyond traditional trade remedy tools. These approaches address a broader scope of divergent regulations, particularly labour and environmental policies, to achieve an LPF.

The usage of LPF as a metaphor varies. The metaphor appeals to the innate sense of fairness of sports fans yet can symbolize symmetry of rules, the equivalence of competitive conditions, uniform outcomes, or equality of opportunity.¹ In international economic law (IEL), there is a convergence among developed countries on a concept of LPF that subjects products, services, and actors to similar regulatory burdens despite various modalities that developed countries use to operationalize the concept.

This article introduces and surveys LPF instruments and operationalizes the concept. It starts by analysing the concept of LPF in international practice and then maps the main LPF instruments, leading to a taxonomy. The latter is used as a basis for providing guidelines on how trade policy should incorporate non-trade concerns.

LPF IN IEL PRACTICE

LPF is a recurring metaphor in international trade negotiations and agreements, with World Trade Organization (WTO) Members invoking it frequently in various contexts, including unilateral actions and multilateral negotiations. For instance, in a WTO meeting in late 2020, representatives from Brazil, Japan, and the USA emphasized the importance of focusing ‘on competition law, trade and investment policies’ to ‘foster a *level playing field* for competition among companies irrespective of ownership, domestically and internationally.’²

This section begins with a concise overview of the conventional understanding of the current state of the international economic system, followed by an introduction to the growing significance of LPF in the trade policies of developed states. It then presents a definition of LPF measures that will serve as the groundwork for subsequent analysis.

Traditional understandings of the International Economic System

The fundamental pillar of the international economic system is ‘arbitrage.’³ Goods are produced in countries with lower manufacturing costs and then exported to yield the highest possible profits. These lower production costs could stem from cheaper materials, more efficient or technologically advanced production methods, reduced wages, or lower regulatory burdens.⁴ In this

¹ On the use of the concept in other instances: Ann E Cudd, ‘Sporting Metaphors: Competition and the Ethos of Capitalism’ (2007) 34 *J Phil Sport* 52; OECD, ‘Chapter 4. Trust and the Level Playing Field - The Evolving State Ownership’ in OECD (ed), *OECD Business and Finance Outlook 2019* (OECD 2019) 95.

² Brazil, Japan, and United States of America, *Importance of Market-Oriented Conditions to the World Trading System: Statement from Brazil, Japan and the United States (Revision)*, Statement to the WTO General Council WT/GC/W/803/Rev.1 (2020) (emphasis added).

³ Arbitrage as basis for the economic system: Joost Pauwelyn, ‘Is Globalization Finally Re-Balancing? Novel Ways of Levelling the Playing Field for Labour’ in George Politakis and others (eds), *ILO 100: Law for Social Justice* (International Labour Organization 2019) 647; Andrew Lang, ‘Heterodox Markets and “Market Distortions” in the Global Trading System’ (2019) 22 *J Intl Econ* 677, 679. It is similar to the concept of ‘comparative advantage’ which, however, examines efficiencies in light of the production possibility frontier of an economy, rather than potential profits of market actors. Most neoclassical models on comparative advantage assume perfect competition where price equals marginal costs; thus, market profits are not examined.

⁴ Alan V Deardorff and others, ‘International Labor Standards and Trade: A Theoretical Analysis’ in Jagdish N Bhagwati and Robert E Hudec (eds), *Fair Trade and Harmonization: Prerequisites for Free Trade?*, vol 1 (MIT Press 1996) 227, 227–29; Paul Krugman, ‘What Should Trade Negotiators Negotiate About?’ (1997) 35 *J Econ Lit* 113; Robert W Staiger, *A World Trading System for the Twenty-First Century* (The MIT Press 2022) ch 11.

setting, the interpretation of the LPF metaphor widely differs from the one introduced in the present article, which focuses on similar regulatory burdens. To the contrary, the traditional understanding argued that as long as merchants (firms or individuals) had equal opportunities to capitalize on these differences, they were competing on a *level playing field*.

IEL was established based on principles of unconditional non-discrimination and reciprocal market access rather than aiming for equality in regulatory burdens.⁵ Hence, differences in domestic regulations were broadly permitted.⁶ This stance is reinforced by early General Agreement on Tariffs and Trade (GATT) case law. For example, the GATT Panel in the *Belgian Family Allowances* case determined that attaching any condition relating to regulatory standards to granting more favourable treatment among trading partners violated Article I GATT 1947.⁷ Consequently, countries could not anticipate that other trade partners would implement similar regulatory conditions and condition market access on such regulatory developments. The sole exception was allowing border adjustments for internal charges imposed on products, not producers or processes.⁸

Moreover, trade liberalization is commonly linked with reduced governmental intervention and an embrace of a free-market ideology.⁹ Every country can establish its own rules and regulations, provided it refrains from discrimination or imposing quantitative restrictions. The multilateral trading system focuses on negative integration obligations. These obligations do not necessitate domestic regulation; instead, they prevent domestic measures from being applied in a protectionist or discriminatory manner that could distort trade concessions.¹⁰

On the flip side, positive integration obligations entail regulatory harmonization processes and a minimum standard of regulatory treatment.¹¹ These obligations are rare in the WTO legal system, apart from the harmonization obligations detailed in the Technical Barriers to Trade Agreement, the Sanitary and Phytosanitary Agreement, and the commitments under the Agreement on Trade-Related Aspects of Intellectual Property Rights. Consequently, domestic differences on the environment, labour, and SOEs remain largely permissible.

WTO Agreements do not mandate a minimum level of environmental or labour protection.¹² Moreover, the regulatory scope of trade rules was confined to instances such as discriminatory application of domestic environmental or labour laws.¹³ Environmental and labour policies were excluded from trade policy, as their impact was viewed as indirect.¹⁴ Likewise, IEL largely

⁵ Aaron James, *Fairness in Practice: A Social Contract for a Global Economy* (Oxford University Press 2012) 74; Jeffrey A Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century* (1st edn, Norton & Company 2007).

⁶ Bernard M Hoekman and Petros C Mavroidis, *The World Trade Organization: Law, Economics, and Politics* (Routledge 2007) 47.

⁷ GATT Panel Report, *Belgian Family Allowances (Allocations Familiales)*, adopted by the Contracting Parties 07 November 1952.

⁸ Charles E McLure, 'A Primer on the Legality of Border Adjustments for Carbon Prices: Through a GATT Darkly' (2011) 5 *Carbon Clim Law Rev* 456; Timothy Meyer, 'Consumption Governance: The Role of Production and Consumption in International Economic Law' (2024) 49 *BYU Law Rev* 1063, 1089.

⁹ Andrew Lang, 'Reflecting on "Linkage"?: Cognitive and Institutional Change in The International Trading System' (2007) 70 *Mod L Rev* 523, 523.

¹⁰ John Ruggie, 'Embedded Liberalism and Postwar Economic Regimes' in John Ruggie (ed), *Constructing the World Polity: Essays on International Institutionalization* (Routledge 1998) 379.

¹¹ Federico Ortino, *Basic Legal Instruments for the Liberalisation of Trade: A Comparative Analysis of EC and WTO Law* (Hart 2004) 17; Jan Tinbergen, *International Economic Integration* (Elsevier 1954) 76, 78–79; John Pinder, 'Positive Integration and Negative Integration: Some Problems of Economic Union in the EEC' (1968) 24 *World Today* 88.

¹² MJ Trebilcock and Joel P Trachtman, *Advanced Introduction to International Trade Law* (2nd edn, Edward Elgar Publishing 2020) chs 14–15.

¹³ Steve Charnovitz, 'The Environment vs. Trade Rules: Defogging the Debate' (1993) 23 *Environ Law* 475, 478.

¹⁴ Douglas A Irwin, *Free Trade under Fire* (1st edn, Princeton University Press 2020) 70.

remained neutral regarding state ownership of firms.¹⁵ The issue of state ownership has risen to prominence only recently, with multiple calls for LPF and competitive neutrality.¹⁶

In sum, the multilateral trading system had traditionally emphasized maintaining the reciprocal balance of concessions, rather than achieving a level playing field.¹⁷ The traditional view of comparative advantage allowed for national disparities in resource endowment, encompassing human, technological, and natural aspects, as well as production factors and standards such as environmental or labour regulations.¹⁸ Traditional trade theories factor in the prevalence of low regulatory compliance costs in defining comparative advantage. Much of the discourse focused on high or low regulatory requirements akin to high or low tariffs, impacting the terms of trade by altering the balance of concessions.¹⁹

LPF in international practice: from the global south to the global north

The Washington Consensus understanding is losing ground as the twenty-first century unfolds. IEL is undergoing a reorientation: While liberalization remains desirable, it is no longer the central aspect of developed countries' agendas. The growing emphasis on LPF is tied to this reorientation process.

The metaphor of the level playing field in IEL originated in the Global South. Developing countries have been critical of the global liberalized economic system since they had a diminished ability to compete on an equal footing with the Global North.²⁰ An illustration of this is evident in the conclusion of the Agreement on Agriculture, which sets limits on agricultural support, and the lack of significant concessions on agriculture goods by developed countries. The agricultural industries of the Global North, historically heavily subsidized and protected, had an advantage over their counterparts in the Global South since developing countries were no longer allowed to subsidize to catch up with the developed countries.²¹ Therefore, agricultural producers from developing countries faced an uneven playing field, as historical protectionism hindered them from leveraging their comparative advantage in major agricultural goods.²²

Recently, the LPF metaphor has been predominantly employed by developed countries deviating from their conventional support for unrestricted free trade when intervening in the

¹⁵ Only non-discrimination and commercial considerations in the SOEs trade practices, in art XVII GATT; See further: Petros C Mavroidis and Merit E Janow, 'Free Markets, State Involvement, and the WTO: Chinese State-Owned Enterprises in the Ring' (2017) 16 *World Trade Rev* 571, 573.

¹⁶ Leonardo Borlini, 'When the Leviathan Goes to the Market: A Critical Evaluation of the Rules Governing State-Owned Enterprises in Trade Agreements' (2020) 33 *LJIL* 313.

¹⁷ Mathias Risse, 'Fairness in Trade' (KSG Faculty Research Working Paper Series, John F Kennedy School of Government, Harvard University 01.2005) 33–34.

¹⁸ Friedl Weiss, 'The Second Tuna GATT Panel Report' (1995) 8 *Leiden J Int Law* 1, 135; Cudd (n 1) 63; James (n 5) 138.

¹⁹ See further: Kyle Bagwell and Robert Staiger, 'Domestic Policies, National Sovereignty, and International Economic Institutions' (2001) 116 *Quart J Econ* 519; Staiger (n 4); Kyle Bagwell and Robert W Staiger, 'An Economic Theory of GATT' (1999) 89 *Am Econ Rev* 215.

²⁰ Eg Sub-Committee on Least Developed Countries (WT/COMTD/LDC/M/16), Comments by Saint Lucia (WT/COMTD/SE/M/1) and Indonesia (WT/COMTD/M/42); Further: Jagdish N Bhagwati, 'Fair Trade, Reciprocity, and Harmonization: The Novel Challenge to the Theory and Policy of Free Trade' in Dominick Salvatore (ed), *Protectionism and World Welfare* (1st edn, Cambridge University Press 1993) 17; Christina L Davis, 'Do WTO Rules Create a Level Playing Field? Lessons from the Experience of Peru and Vietnam' in John S Odell (ed), *Negotiating Trade: Developing Countries in the WTO and NAFTA* (Cambridge University Press 2006) 219.

²¹ Eg comments by India (WT/GC/W/152), Pakistan, South Africa and Mauritius (G/AG/NG/R/5), and Brazil (TN/AG/R/5). Further: Ethan B Kapstein, *Economic Justice in an Unfair World: Toward a Level Playing Field* (Princeton University Press 2008) 65; Erich Supper, 'Is There Effectively a Level Playing Field for Developing Country Exports' Study Series No 1, Policy Issues in International Trade and Commodities (UNCTAD 2001).

²² See similar for industrial policy . comments by Pakistan (WT/MIN(98)/WS/M/1) and Mauritius (WT/MIN(98)/WS/M/2). Further: Joseph E Stiglitz, *Globalization and Its Discontents* (Norton 2003) 62.

market.²³ Countries and bodies like the UK,²⁴ the EU,²⁵ the USA,²⁶ Japan,²⁷ and Switzerland²⁸ have adopted measures, concluded treaties, and proposed multilateral accords concerning trade, labour, and the environment to achieve an LPF.²⁹ These initiatives can be traced back to US efforts, starting as early as the Tokyo Round,³⁰ aimed at introducing labour obligations in the GATT to prevent a ‘race to the bottom.’³¹

The striking commonality among these measures is their aim to balance the regulatory and economic burden on market actors across different jurisdictions. Achieving this might necessitate regulatory interventions to set minimum horizontal rules and standards, or to reduce government intervention, preventing an *unfair* advantage to market actors operating under looser environmental/labour rules or significant governmental support.³²

Definition of LPF

Though several measures exist, a precise definition of the term LPF remains elusive, and existing definitions offer limited help.³³ This paper considers LPF measures to include trade measures that establish the same (or equivalent) regulatory burdens or aim to evenly distribute this burden among actors and supply chains across different jurisdictions.³⁴

The concept of LPF evokes the theoretical image of a ‘flat world’, reminiscent of Friedman’s perspective.³⁵ Yet governmental intervention via LPF measures demonstrates that globalization *per se* has not led to a flattened world.³⁶ Instead, governmental intervention is essential to ensure the benefits of globalization, which extend beyond economic realms to encompass sustainability and non-trade concerns. Concerns for fairness necessitate the integration of sustainable development into trade policy,³⁷ alongside the requirements of competitive neutrality.³⁸

The existing system based on border measures, such as tariffs, is inadequate, especially in the context of externalities not reflected in product prices, such as social or environmental costs

²³ Also developing countries: eg Costa Rica (JOB/AG/243), and Malaysia on behalf of ASEAN countries (PC/SCTE/M/3).

²⁴ Subsidy Control Act, 2022 c.23/2022, UK Public General Acts.

²⁵ European Commission, *Trade Policy Review—An Open, Sustainable and Assertive Trade Policy*, COM(2021) 66 final (Brussels, 18 February 2021).

²⁶ Ambassador Michael BG Froman, Office of the United States Trade Representative, *2014 Trade Policy Agenda*, Report of Section 163 of the Trade Act of 1974, as amended (19 U.S.C. 2213); 89 Fed Reg 29,850 (9 May 2023).

²⁷ Act on Promotion of Use and Distribution of Legally-harvested Wood and Wood Products (20 May 2017).

²⁸ Comprehensive Economic Partnership Agreement between the Republic of Indonesia and the EFTA States (01 November 2021).

²⁹ LPF is mentioned explicitly as a goal in most of these instruments (eg EU’s and US’ trade policy agendas, the EU Anti-deforestation Regulation and the Subsidy Control Act), while the rest have a similar operation, even without explicitly referring to LPF.

³⁰ Montserrat González Garibay, ‘The Trade-Labour Linkage from the Eyes of the Developing Countries: A Euphemism for Protectionist Practices’ (2009) 14 *Eur Foreign Aff Rev* 767.

³¹ This has been a high priority for the USA at least since the early WTO days and has remained so since through the US PTA policy.

³² Matilda Gillis, ‘Let’s Play?: An Examination of the “Level Playing Field” in EU Free Trade Agreements’ (2021) 55 *J World Trade* 715; Brigida Laffan and others, *Europe’s Experimental Union: Rethinking Integration* (Routledge 2000).

³³ Eg common rules and standards that prevent businesses in one country gaining a competitive advantage over those operating in other countries, in Regulation (EU) 2023/1542 of the European Parliament and of the Council of 12 July 2023 concerning batteries and waste batteries, amending Directive 2008/98/EC and Regulation (EU) 2019/1020 and repealing Directive 2006/66/EC, OJ L 191 (28 July 2023).

³⁴ LPF as equalization of regulatory burden affects also international investment law (eg the Foreign Subsidies Regulation addresses foreign subsidized investments, or similarly Investment Treaties introduce minimum regulatory requirements, such as labour and environmental provisions, or investor obligation’s towards corporate social responsibility). Due to limited space, the present paper does not examine in detail the application on LPF to investment treaties. The analysis though is similar.

³⁵ Thomas L Friedman, *The World is Flat: A Brief History of the Twenty-First Century* (3rd edn, Picador 2007).

³⁶ See Stiglitz (n 21).

³⁷ ECJ, *Opinion 2/15 of the Court: Free Trade Agreement between the European Union and the Republic of Singapore (Full Court)* (16 June 2017), para 163; Gillis (n 32) 735.

³⁸ OECD, ‘Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options’ (OECD Corporate Governance Working Papers 2011); United Nations Conference on Trade and Development, ‘Competitive Neutrality and Its Application in Selected Developing Countries’ (UNCTAD Research Partnership Platform Publication Series 2014).

or unfair governmental intervention.³⁹ Under this approach, non-trade concerns are no longer viewed as separate from traditional ‘trade values’;⁴⁰ they are now regarded as an integral part of trade. Bartels explains that LPF examines non-trade concerns as an integral trade policy component, ensuring that regulatory costs are equalized on both sides. This should not be misconstrued as enforcing non-trade concerns but rather as ‘hard-nosed economics at its best.’⁴¹

In essence, LPF entails a state of equal competitive conditions, undistorted by government intervention and regulatory divergences, aiming to achieve similar regulatory costs in the production and operation of market actors and their supply chains.

MAPPING LPF INSTRUMENTS

The mapping developed captures diverse aspects of LPF measures and initiatives, yielding a new taxonomy. This taxonomy sheds light on the operation of these measures, setting the stage for assessing the legal and economic implications within each category. It reveals the potential for achieving—or at least striving for—the equalization of regulatory burdens across various actors and supply chains through various approaches.

Introduction method: unilateral, plurilateral, and multilateral

The first distinction concerns how states introduce these measures. An LPF measure may be implemented through unilateral domestic regulations, bilateral or plurilateral agreements or schemes, or multilateral accords. Each approach presents varying legal, economic, and policy implications akin to the debate surrounding trade agreements, unilateral actions, and preferential liberalization.⁴² For instance, evidence of the effectiveness of labour-related LPF measures in promoting higher labour standards varies.⁴³ Multilateral approaches have demonstrated limited influence on enhancing labour protections,⁴⁴ whereas bilateral commitments may yield adverse effects.⁴⁵ Conversely, specific unilateral measures, such as extraterritorial due diligence obligations, have been found effective, although their compliance with WTO regulations might be contentious.⁴⁶

Enforcement method: active and passive enforcement

The second distinction concerns how LPF instruments are enforced and whether they are actively or passively extended. The passive category includes instruments that mandate market actors to operate, manufacture, or produce in a specific manner as a requirement for market

³⁹ Patrick Macrory and Arthur Appleton, ‘Heterodox Views: What Is Wrong With the WTO and How to Fix It’ (2022) 56 *J World Trade* 714.

⁴⁰ See Lang (n 9) 538; Matilda Gillis, ‘The “Level Playing Field” Metaphor: Revealing a Competitive Move in EU Free Trade Agreements’ (2023) 57 *J World Trade* 125.

⁴¹ Lorand Bartels summarized the concept in a House of Lords evidence session on the level playing field on 27 February 2020 <<https://committees.parliament.uk/event/275/formal-meeting-oral-evidence-session/>> last accessed 10 July 2024. Referred to as ‘the fair competition story’ in Alice Pirlot, ‘Carbon Border Adjustment Measures: A Straightforward Multi-Purpose Climate Change Instrument?’ (2022) 34 *J Environ Law* 25, and Gillis (n 40); Both authors argue that the competition argument (not the values or climate change one) is stronger. Still, many of the measures may be introduced in association with ‘moral values’. See further: Garibay (n 30) 769.

⁴² Indicatively: Steve Charnovitz, ‘Environmental Trade Measures: Multilateral or Unilateral Other International Developments’ (1993) 23 *Environ Pol Law* 154; Lang (n 3) 677; Joost Pauwelyn, ‘The End of Differential Treatment for Developing Countries? Lessons from the Trade and Climate Change Regimes’ (2013) 22 *Rev Eur Comp Int Environ Law* 29.

⁴³ The examples below are illustrative and should not be considered as generalized conclusions. Rather these examples are introduced in order to demonstrate that the effectiveness of each category of measures should not be presumed.

⁴⁴ TN Srinivasan, ‘International Trade and Labor Standards’ in Arvid Lukauskas and others (eds), *Handbook of Trade Policy for Development* (Oxford University Press 2013) 922.

⁴⁵ Ryan Abman and others, ‘Child Labor Standards in Regional Trade Agreements: Theory and Evidence’ (National Bureau of Economic Research February 2023).

⁴⁶ See on due diligence schemes: Alonso Alfaro-Urena and others, ‘Responsible Sourcing? Theory and Evidence from Costa Rica’ (Working Paper, National Bureau of Economic Research November 2022); Boudreau, Laura, ‘Multinational Enforcement of Labor Law: Experimental Evidence on Strengthening Occupational Safety and Health (OSH) Committees’, *Econometrica* (forthcoming).

entry, whether through imports or sales, or under more or less favourable conditions for market access. Conversely, 'active enforcement' instruments directly impose rules on production methods and supply chain governance on market actors, irrespective if the particular action takes place within or beyond national jurisdictions.⁴⁷

On the one hand, passive enforcement primarily aims to prevent a 'race to the bottom' concerning labour and environmental standards. It encourages higher levels of protection through advantageous or disadvantageous conditions for market entry.⁴⁸ These instances are often considered as part of 'trade conditionalities' that connect economic penalties or incentives to obligations related to labour and the environment.⁴⁹

Unilateral measures often establish minimum environmental or labour standards for goods and services,⁵⁰ exemplified by the 'Brussels Effect'.⁵¹ The EU sets regulatory standards that serve as prerequisites for market access, compelling foreign exporters or nations to harmonize their practices with the EU's framework, essentially establishing the EU as a *de facto* transnational regulator,⁵² thus promoting a transnational LPF based on EU regulations.⁵³

Passive enforcement operates on an incentive basis. Its efficacy in influencing private actors (or their home states) depends on factors such as the size of the target market, reliance on covered exports, and the actual treatment of compliant and non-compliant goods.⁵⁴

On the other hand, active enforcement instruments actively examine breaches of LPF-related disciplines within or beyond the national market and enforce remedies. These measures are particularly important, making trade and sustainability considerations both a 'shield and a 'sword' for traditional trade measures.⁵⁵ These may address both state actions, eg failure to implement Multilateral Environmental Agreements (MEAs) and International Labour Organization (ILO) conventions, and private actions, eg hazardous production methods.⁵⁶

For instance, Carbon Border Adjustment Mechanisms (CBAMs) illustrate the 'active enforcement' approach, using sustainability considerations as a 'sword'. The EU CBAM will require companies that export goods produced abroad to the EU to purchase CBAM certificates corresponding to the emissions generated in the production process of those goods.⁵⁷ Even if the measure has a trade narrative, the remedy is linked to carbon pricing, not trade effects.

⁴⁷ In this regard, Lorand Bartels, 'Article XX of GATT and the Problem of Extraterritorial Jurisdiction: The Case of Trade Measures for the Protection of Human Rights' (2002), 36 J World Trade 353, 381, suggests a difference between measures that have an extraterritorial effect and measures that are defined by something located or occurring abroad.

⁴⁸ See Gillis (n 32) 737.

⁴⁹ Also referred to as 'mirror measures' since they require a mirroring of domestic environmental, animal welfare or health standards and regulations for market access, Pascal Lamy and others, 'A Narrow Path for EU Agri-Food Mirror Measures' (Policy Paper, Greening Agri-food Policy in the EU (GRAPE), Europe Jacques Delors 04.2022).

⁵⁰ Eg the EU General System of Preferences.

⁵¹ Anu Bradford, *The Brussels Effect: How the European Union Rules the World* (Oxford University Press 2020); Kai Purnhagen and Dominique Sinopoli, 'Reversed Harmonization or Horizontalization of EU Standards? Or: Does WTO Law Facilitate or Constrain the Brussels Effect?' (2016) 34 Wisconsin Int Law J 92.

⁵² Bradford (n 51) 25–66.

⁵³ See Purnhagen and Sinopoli (n 51).

⁵⁴ For instance, the preferential treatment of sustainable palm oil under the EFTA–Indonesia FTA does not significantly promote the trade of compliant palm oil, since the tariff treatment of non-sustainable palm oil is already significantly favourable. In contrast, a large part of the Swiss–Indonesia trade on palm oil is related to animal feed which is not subject to the sustainability scheme (James Harrison, 'Trade Agreements and Sustainability: Exploring the Potential of Global Value Chain (GVC) Obligations' (2023) 26 J Int Econ Law 199, 209.

⁵⁵ See for instance: 89 Fed Reg 29,850 (9 May 2023) (low environmental regulations as a 'sword' for higher AD duties) and European Commission, Guidelines on the applicability of art 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (2023/C 259/01) 21 July 2023 ('sustainability' as a shield for non-breach of antitrust rules). Similar analysis for competition law and sustainability: Elias Deutscher and Stavros Makris, 'Sustainability Concerns in EU Merger Control: From Output-Maximising to Polycentric Innovation Competition' (2023) 11 J Antitrust Enforc 350.

⁵⁶ Kathleen Claussen, 'Trade's Enforcement Conundrum' in Voigt C and Foster C (eds), *International Courts versus Non-Compliance Mechanisms: Comparative Advantages in Strengthening Treaty Implementation* (Cambridge University Press 2024) 171.

⁵⁷ art 9, Reg (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism, OJ L 130. Details on enforcement: Joost Pauwelyn, 'Twenty-First Century Customs Fraud: How to Effectively Enforce EU Sustainability Requirements on Imports' (2024) 27 J Int Econ Law 203.

Similarly, the EU Foreign Subsidies Regulation (FSR) allows the European Commission to impose redressive measures. Aside from fines and penalty payments,⁵⁸ and the possibility of repaying the subsidies given,⁵⁹ the FSR encompasses additional redressive measures, such as behavioural or structural remedies. Sustainability or other general efficiency considerations may constitute a ‘shield’ for the undertaking under scrutiny.⁶⁰

Active enforcement instruments of LPF also appear in Preferential Trade Agreements (PTAs), like the EU–UK Trade and Cooperation Agreement (TCA), which allows parties to address significant regulatory divergences with appropriate ‘rebalancing measures’ related to labour, social, and environmental regulation.⁶¹ Furthermore, active enforcement measures may respond to breaches of environmental or labour provisions through redressive measures⁶² or even economic sanctions.⁶³ Termination or suspension of PTAs is another approach of enforcing such standards, especially in case of serious breaches of climate change and labour commitments.⁶⁴

Due to their severity and intrusiveness, active enforcement measures are linked to more rigorous legal standards and procedures.⁶⁵ In contrast, passive enforcement measures may operate discreetly and are typically more technically oriented despite their equally significant impact on market access perspectives.

Level of harmonization: variable geometry and equivalence

The third distinction for LPF instruments relates to the degree of convergence and harmonization required. The instruments may entail:

- identical standards (or regulation);⁶⁶
- equivalent standards;⁶⁷ and/or
- a minimum standard.⁶⁸

Certain measures acknowledge the variance in standards but allow for unilateral adjustments when there is a ‘distortive’ divergence. Therefore, regulatory harmonization or balancing regulatory burden may differ across instances and trade partners. This variance in the degree of consistency is associated with the concept of ‘variable geometry’ and graded LPF. ‘Variable geometry’ has been primarily used for plurilateral initiatives within the WTO, where members

⁵⁸ art 15, Reg (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market, OJ L 330.

⁵⁹ *ibid*, art 6.6.

⁶⁰ Marios Tokas, ‘Playing the Game: The EU’s Proposed Regulation on Foreign Subsidies’ (2022) 56 *J World Trade* 797. Similar to state aid in a recent call for consultations by the European Commission <https://competition-policy.ec.europa.eu/state-aid/publications/targeted-consultation_en> accessed 18 July 2024.

⁶¹ art 411, Trade and Cooperation Agreement between the European Union and the European Atomic Energy Community, of the One Part, and the United Kingdom of Great Britain and Northern Ireland, of the other Part, 31 December 2020, OJ L 444/14.

⁶² Panel of Experts, *Panel of Expert Proceedings constituted under Article 13.15 of the EU-Korea Free Trade Agreement (Report)*, 20 January 2021.

⁶³ art 26.16(2) Free Trade Agreement between the European Union and New Zealand, 30 June 2022, OJ L 2024/866. See for instance: Panel, *In the Matter of Guatemala—Issues Relating to the Obligations Under Article 16.2.1(a) of the CAFTA-DR (Report)*, 14 June 2017.

⁶⁴ art 772, EU–UK TCA.

⁶⁵ Jagdish N Bhagwati, *In Defense of Globalization* (Oxford University Press 2004) 342.

⁶⁶ Juan A Marchetti and Petros C Mavroidis, ‘I Now Recognize You (and Only You) as Equal: An Anatomy of (Mutual) Recognition Agreements in the GATS’ in Ioannis Lianos and Okeoghene Odudu (eds), *Regulating Trade in Services in the EU and the WTO: Trust, Distrust and Economic Integration* (Cambridge University Press 2012) 415.

⁶⁷ Pieter Pauw and others, ‘The CBAM Effect: How the World is Responding to the EU’s New Climate Stick’ (Clingendael Alert, Netherlands Institute of International Relations 05.2022).

⁶⁸ Gillis (n 32).

seek deeper integration without the consensus rule, allowing for progressive integration of future members.⁶⁹

Extending this concept beyond the WTO, the paper applies the idea of variable geometry to PTAs and unilateral regulations. It proposes that the concept of LPF could be applied in variable 'grades'. Obligations are imposed depending on the level and intensity of market integration, geographic proximity, and various economic or non-economic factors, akin to the 'gravity model' used in international economics and trade policy. This model analyses trade flows between countries by examining the distance between the trade partners and their size.⁷⁰

This notion of a graded LPF is apparent in agreements between the EU and third-party states. The closer the country's economic or trade relations align with the EU, and the greater the access to the common market is provided, the more rigorous the LPF obligations become.⁷¹ A prime example is the EU–UK TCA, which has instituted extensive LPF obligations. These stringent measures aim to prevent substantial distortions that could arise from even minor regulatory divergences due to the intense integration between markets and their geographical proximity.⁷² The TCA necessitates comprehensive non-regression commitments concerning labour and environmental standards, the effective application and enforcement of competition laws and subsidy control,⁷³ equivalent regulation of SOEs, and commitments against tax standards regression.

Overall, the EU extends its LPF ambitions to its closest partners, particularly candidate EU Member States, by integrating provisions for harmonization with the EU *acquis communautaire*.⁷⁴ As the geographical distance between the EU and its partners increases, similar but less intense harmonization provisions with EU laws and regulations are observed.⁷⁵ These measures aim to facilitate deeper integration with the internal market, ensuring that expanded market access does not result in distorted competitive conditions due to regulatory divergence.

The intriguing scenario pertains to the relationship between market integration, proximity, and the potential for distortion. In certain cases, an identical regulatory framework is unnecessary for achieving LPF. For instance, if markets are sufficiently distant, any disparities in climate change policies may not significantly distort the intended outcome. The guiding principle in such cases is to allow differences as long as they do not hinder the shared policy goal or the associated economic competitiveness objectives. Thus, a CBAM could exclude Small Island Developing States producers whose trade distorting potential is small if the fear of carbon leakage is minimal.

⁶⁹ Bernard M Hoekman and Petros C Mavroidis, 'Variable Geometry in the WTO' in Robert Schütze (ed), *Globalisation and Governance: International Problems, European Solutions* (Cambridge University Press 2018) 148; Bernard M Hoekman and Petros C Mavroidis, 'WTO "à La Carte" or "Menu Du Jour"? Assessing the Case for More Plurilateral Agreements' (2015) 26 *Eur J Int Law* 319.

⁷⁰ See: Tinbergen (n 11); Sophie Soete and Jan Van Hove, 'Dissecting the Trade Effects of Europe's Economic Integration Agreements' (2017) 32 *J Econ Integr* 193; Costas Arkolakis and others, 'New Trade Models, Same Old Gains?' (2012) 102 *Am Econ Rev* 94; Robert C Feenstra and others, 'Using the Gravity Equation to Differentiate among Alternative Theories of Trade' (2001) 34 *Can J Econ* 430.

⁷¹ Marja-Liisa Öberg, 'Internal Market Acquis as a Tool in EU External Relations: From Integration to Disintegration' (2020) 47 *Leg Issues Econ Integ* 2.

⁷² Paola Mariani and Giorgio Sacerdoti, 'Trade in Goods and Level Playing Field' in Federico Fabbrini (ed), *The Law & Politics of Brexit: Volume III: The Framework of New EU-UK Relations* (Oxford University Press 2021) 100.

⁷³ With detailed definitions and provisions both on the substantive and the procedural/enforcement side.

⁷⁴ Alasdair R Young and John Peterson, 'The EU and the New Trade Politics' (2006) 13 *J Eur Public Policy* 795, 795.

⁷⁵ Jan Zielonka, 'Europe as a Global Actor: Empire by Example?' (2008) 84 *Int Aff* 471.

The concept of 'graded' LPF obligations is observable in trade and climate change policies.⁷⁶ Various models of 'climate equivalence' may be adopted, from aligning emissions trading systems,⁷⁷ to establish shared methodologies and minimum standards,⁷⁸ over benchmarking based on mutual objectives despite divergent methodologies and standards,⁷⁹ to implement pricing mechanisms involving tariffs or financial penalties to counter climate change discrepancies.

Remedies: prohibition and pricing mechanisms

The fourth distinction concerns the type of remedy or redressive measure imposed by an LPF measure, distinguishing between prohibition and pricing mechanism.

Firstly, an instrument may entirely prohibit the entry of a product, service or market actor or specific actions taken by a country or market actor. An example is the proposed EU Regulation on forced labour, which aims to ban products associated with forced labour to 'ensure a level playing field for businesses established within and outside the EU'.⁸⁰ Within this category, the paper classifies PTA provisions that prohibit regulatory practices, like non-regression obligations from existing levels of environmental protection.⁸¹ In such instances, the action, product, or service in question is inherently considered 'unfair' or 'illegal' per se, without a specific examination of its market effects.⁸² The source of this illegality or unfairness is typically a norm or a principle, such as those concerning environmental, labour, or human rights.

Secondly, an instrument can acknowledge the presence of distortions or regulatory divergences. Instead of prohibiting or discriminating between compliant and non-compliant products/services, the measure aims to address this discrepancy by pricing the distortion or divergence, essentially implementing a 'countervailing price' mechanism. For instance, the CBAM is a pricing mechanism designed to prevent distortions and negative externalities resulting from regulatory divergencies in climate change policies. Within the 'pricing' category, other examples might involve antitrust measures, such as those outlined in the FSR, which price the distortion by imposing a behavioural (which could entail pricing) or structural remedy to countervail this distortion.

In general, pricing mechanisms are not novel, as the WTO Agreement explicitly permits the imposition of antidumping and countervailing duties to address damage to domestic industries.⁸³ The process of 'pricing' a divergence is especially relevant when imposing 'trade sanctions' for breaches in labour and climate change commitments with trade effects in PTAs.⁸⁴

⁷⁶ For more: Emily Lydgate, 'Climate Equivalence and International Trade' (2023) 22 *World Trade Rev* 484, 495; Geraldo Vidigal and Ingo Venzke, 'Of False Conflicts and Real Challenges: Trade Agreements, Climate Clubs, and Border Adjustments' (2022) 116 *Am J Int Law* 202, 240.

⁷⁷ William Nordhaus, 'Climate Clubs: Overcoming Free-Riding in International Climate Policy' (2015) 105 *Am Econ Rev* 1339.

⁷⁸ Federal Government of Germany, *G7 presidency programme* (2022) <<https://www.g7germany.de/g7-en/current-information/g7-presidency-programme-2,000,772>> accessed 06 July 2024.

⁷⁹ Such as the EU-UK TCA that simply provides for the common goal of climate neutrality by 2050, without specifying the modalities or standards for achieving this, aside from the obligation to introduce carbon pricing policies.

⁸⁰ Proposal for a Regulation of the European Parliament and of the Council on prohibiting products made with forced labour on the Union market 14 September 2022; Similar considerations in the Uyghur Forced Labor Prevention Act 12 August 2021 (HR); Modern Slavery Act 2015, UK Public General Acts 2015 c. 30, Australia's Modern Slavery Act 2018, No 153, 2018; Acuerdo que establece las mercancías cuya importación está sujeta a regulación a cargo de la Secretaría del Trabajo y Previsión Social, Diario Oficial de la Federación 17 February 2023.

⁸¹ Marco Bronckers and Giovanni Gruni, 'Retooling the Sustainability Standards in EU Free Trade Agreements' (2021) 24 *J Int Econ Law* 25, 26. Also in art 11.4 of the EFTA-Philippines CEPA.

⁸² It is possible that the particular action has been generally assessed as distortive (eg at the impact assessment report of the measure), but the application of the measure to the specific circumstances does not necessitate an analysis of market effects. It may require though an analysis of sustainability related concerns (eg proof of forced labour).

⁸³ Certain WTO Members also introduce LPF-related considerations in trade remedies pricing mechanisms when examining the cost of production of a product and disregard prices distorted by governmental intervention. For more: Weihuan Zhou, 'Appellate Body Report on EU-Biodiesel: The Future of China's State Capitalism under the WTO Anti-Dumping Agreement' (2018) 17 *World Trade Rev* 4, 609.

⁸⁴ Gracia Marín Durán, 'Sustainable Development Chapters in EU Free Trade Agreements: Emerging Compliance Issues' (2020) 57 *Common Mark Law Rev* 1063; Kathleen Claussen, 'Reimagining Trade-Plus Compliance: The Labor Story' (2020) 23 *J Intl Econ L* 25, 36.

Another pricing mechanism involves providing more favourable tariff treatment for goods produced according to specific sustainability standards,⁸⁵ or implementing rebalancing measures to prevent adverse impacts on trade and investment resulting from substantial differences in sustainability regulations.⁸⁶ By allowing a party to react to regulatory divergence without a precise breach of an obligation, the latter resembles non-violation complaints in WTO law.⁸⁷

This distinction between prohibition and pricing mirrors the existing regulation of subsidies under the SCM Agreement ('prohibited' and 'actionable' subsidies), as well as antitrust regulation,⁸⁸ where certain actions are prohibited *as such*, while others are prohibited due to their *effects*. LPF exists as a more abstract concept for the former, with certain fundamental principles or rules that should be adhered to (eg combatting deforestation). For the latter, LPF operates as a *theory of harm* (eg carbon border charges, even without quantifiable trade effects)⁸⁹ or a *rule of reason* (eg leaving a foreign subsidy unaddressed, despite its trade effects, due to net sustainability gains).⁹⁰ This connects trade and non-trade concerns by monetizing non-trade concerns.

Source of unfair advantage: government or private practice

An additional distinction between LPF measures can be made between measures targeting unfair governmental practices and those addressing unfair private practices.

On the one side, LPF measures aim to tackle unfair subsidies, low environmental and labour regulations, unfair favourable regulatory treatment or operation of SOEs, and governmental interventions affecting the production cost of exported goods. For example, in Article 17.6(3), the CPTPP prohibits non-commercial assistance to SOEs if this assistance is provided 'concerning the production and sale of a good by the state-owned enterprise.'⁹¹ Similarly, the USMCA includes extensive labour obligations, demanding that the parties adjust their domestic legislation or effectively enforce international labour instruments.⁹² These approaches are established within bilateral or multilateral accords based on the parties' agreement on the minimum standard required for conducting trade and investment relations on an LPF.⁹³

On the other side, measures targeting private actions link LPF with eliminating unfair trade practices such as dumping, low environmental or labour process and production methods (PPMs), and breaches of corporate social responsibility. The focus in this realm could be the traded product,⁹⁴ the economic entity,⁹⁵ or theoretically the worker.⁹⁶ For instance, the proposed EU forced labour regulation seeks to enforce ILO conventions and regulations directly on

⁸⁵ Eg. Asia-Pacific Economic Cooperation Representatives Declaration, 09 September 2012; pricing may also entail an additional tariff being imposed as price compensation for differences in raw materials prices (eg EFTA-Jordan Protocol A).

⁸⁶ See Lydgate (n 76). It has been previously suggested that this rebalancing process in the GATT should be extended to changes in labour regulations and for diverse carbon-related measures, Bagwell and Staiger (n 19); Staiger (n 4) 169–81, respectively.

⁸⁷ For more: Locknie Hsu, 'Non-Violation Complaints: WTO Issues and Recent Free Trade Agreements' (2005) 39 J World Trade 205; Christophe Larouer, 'WTO Non-Violation Complaints: A Misunderstood Remedy in the WTO Dispute Settlement System' (2006) 53 Neth Int Law Rev 97; Frieder Roessler, 'Should Principles of Competition Policy Be Incorporated into WTO Law through Non-Violation Complaints?' (1999) 2 J Intl Econ Law 413.

⁸⁸ Anti-trust regulation distinguishes between *by-object* and *by-effect breaches*, as well as regulatory prohibition of certain actions even without precise anti-competitive effects (Pablo Ibáñez Colomo, 'The Draft Digital Markets Act: A Legal and Institutional Analysis' (2021) 12 J Eur Compet Law Pract 561; Arndt Christiansen and Wolfgang Kerber, 'Competition Policy with Optimally Differentiated Rules Instead of "Per Se Ruls vs Rule of Reason"' (2006) 2 J Compet Law Econ 215).

⁸⁹ Or take into account sustainability considerations when calculating the normal price of a good in antidumping duties.

⁹⁰ Such as sustainability exceptions for anticompetitive actions.

⁹¹ Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), 08 March 2018.

⁹² Chapter 23, United States—Mexico—Canada Agreement (USMCA), 30 November 2018.

⁹³ Andrew D Mitchell and James Munro, 'An International Law Principle of Non-Regression from Environmental Protections' (2023) 72 Int Comp Law Quart 35; Clotilde Granger and Jean-Marc Siroën, 'Core Labour Standards in Trade Agreements: From Multilateralism to Bilateralism' (2006) 40 J World Trade 813.

⁹⁴ Palm oil in EFTA—Indonesia CEPA.

⁹⁵ See Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859, OJ L 2024/1760.

⁹⁶ These distinctions on LPF measures have been taken from Pauwelyn (n 3).

economic operators. The instrument prohibits products but focuses on the economic operator and supply chain. The ‘unfair’ advantage from breaching labour standards is not associated with state practice but rather with the internal policy of the economic operators.⁹⁷ These measures are primarily introduced unilaterally, as states avoid *de jure* differentiating between countries of origin, concentrating instead on the specific conduct of private actors.

Measures examine both governmental and private practices. For example, the EU Anti-Deforestation Regulation introduces obligations towards private actors and their supply chains, but the practice of states is also relevant. In their deforestation-free due diligence statements, commodity importers will face varying due diligence obligations based on whether they are located in a low-risk or high-risk country.⁹⁸ The country’s risk assessment is tied to its policies, such as its nationally determined contributions under the Paris Agreement and its agreements with the EU concerning deforestation.

The distinction between the two sources of ‘unfairness’ can be linked to the concept of product and non-product related PPMs.⁹⁹ When the advantage is associated with the domestic regulatory and political environment, the connection between the product/service and the unfair advantage is more remote and potentially could be challenged. Conversely, when ‘unfairness’ stems from the operations of the market actor and its supply chain, this ‘unfairness’ may have more identifiable trade effects. Moreover, governmentally-derived advantages may be specific to the case (provision of a subsidy) or general (lack of adequate subsidy or state-aid control mechanism).

LPF standards: efficiency and minimum regulatory standards

The final and most crucial part of the taxonomy lies in the standard of LPF, determining where lines are drawn between fair and unfair advantages that need ‘levelling.’ Three primary categories, or ‘lines drawn,’ can be identified:

- *the liberal/traditional approach*: LPF implies minimal governmental intervention in the market unless necessary for public policy objectives;
- *the efficiency approach*: LPF necessitates a balancing exercise between the gains derived from governmental intervention and the gains absent such intervention;
- *the externalities approach*: LPF is linked with governmental intervention that harmonizes the externalities incorporated in the prices of goods and services. The externalities encompass social and environmental costs. LPF measures aim to equalize regulatory and compliance costs among economic operators in different jurisdictions, without conducting a specific balancing exercise as in the efficiency approach.

Liberal approach: addressing market failures

The liberal approach is evident in the subsidy provision clauses of agreements such as the EU–UK TCA. In these clauses, subsidy control is tethered to avoiding substantial impacts on trade or investment.¹⁰⁰ Subsidies that have such an effect are prohibited. However, the agreement allows subsidies designed to address a market failure or equity considerations,¹⁰¹ provided they

⁹⁷ *ibid* 651.

⁹⁸ art 27, Reg (EU) 2023/1115 of the European Parliament and of the Council of 31 May 2023 on the making available on the Union market and the export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing Regulation (EU) No 995/2010 OJ L 150. See further: Gregory Messenger, ‘Mitigating the Rise of Unilateralism: Lessons from Forestry Management’ (2024) 27 J Int Econ Law 223.

⁹⁹ Steve Charnovitz, ‘The Law of Environmental “PPMs” in the WTO: Debunking the Myth of Illegality’ (2002) 27 Yale J Int Law 59; Robert Howse and Donald Regan, ‘The Product/Process Distinction - An Illusory Basis for Disciplining “Unilateralism” in Trade Policy’ (2000) 11 Eur J Int Law 249.

¹⁰⁰ art 366.

¹⁰¹ Such as social difficulties of distributional concerns.

meet specific criteria: The subsidies should be proportional to and necessary for the objective's attainment, they should influence the beneficiary's economic behaviour towards the objective's attainment, and the objective would not be accomplished without them.¹⁰² Moreover, a comprehensive evaluation examines the measure's net effects, weighing the negative impact on trade or investment against the positive contributions.¹⁰³

This provision introduces a test akin to a general exception permitting policy considerations based on necessity, even economic necessity, through a balancing exercise.¹⁰⁴ However, the objective must be tied to rectifying a market failure or equity rationale. Hence, subsidies are allowed only when the market cannot deliver the required outcome.¹⁰⁵

The phrasing of the provision appears to prioritize safeguarding trade and investment by setting stringent criteria for governmental intervention. Therefore, priority is given to less interventionist policies.¹⁰⁶ LPE, in this context, thus calls for rare and only necessary governmental interventions.

This approach reflects a negative integration approach, since no minimum standard of protection is introduced, while any level of protection is acceptable as long as it passes the necessity test. Critically, though, it provides a more flexible policy approach towards subsidization away from the traditional 'traffic-light' system of the WTO.

Efficiency approach

The efficiency approach is observed in subsidy control or remedial measures, such as the FSR, which does not require a necessity analysis nor a public policy objective. Instead, the European Commission evaluates the level of distortion caused by a foreign subsidy in the EU internal market. It then conducts a balancing assessment by weighing the distortions against the positive effects of the foreign subsidy.

The nature of this balancing test typically favours the recipient of foreign subsidies, since the Commission is tasked with demonstrating that the distortions caused outweigh the positive effects of the subsidies.¹⁰⁷ Consequently, this test permits the Commission to leave subsidies unredressed to the extent that these support competitive conditions in the relevant economic activity in the internal market, alongside non-economic considerations such as 'broader positive effects in relation to the relevant policy objectives'.¹⁰⁸ This framework allows for certain divergences arising from regulatory interventions if they result in efficiency gains.

Externalities approach: equating social and regulatory costs

The third approach includes externalities in the cost of products and services, deriving from diverse regulatory and social costs.¹⁰⁹ It primarily mandates the establishment of minimum environmental and labour conditions that affect competitive conditions. Countries should intervene by introducing and enforcing minimum standards, which may be tied to the signature of an

¹⁰² The subsidy should not be compensative for the costs that could be funded by the beneficiary even without the governmental intervention.

¹⁰³ A similar approach has been adopted in the UK Subsidy Control Act.

¹⁰⁴ See WTO case law on 'weighting and balancing' and 'less trade restrictive alternative', such as WTO Appellate Body Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, adopted 17 December 2007; WTO Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998.

¹⁰⁵ Similar standard applies to rebalancing measures, See Lydgate (n 76) 500.

¹⁰⁶ The structure reminds of Pigouvian responses to non-trade concerns, Joseph F François and others, 'Trade and Sustainable Development: Non-Economic Objectives in the Theory of Economic Policy' (2023) 22 *World Trade Rev* 463; Richard Cornes and Todd Sandler, *The Theory of Externalities, Public Goods, and Club Goods* (2nd edn, Cambridge University Press 1996) 68–91.

¹⁰⁷ Tokas (n 60) 800.

¹⁰⁸ art 6.1, FSR.

¹⁰⁹ 89 Fed Reg 29,850, 29,859, provides 'These examples of foreign government inaction could result in costs and prices that are unreasonably suppressed and create an unlevel playing field between producers and suppliers in countries in which governments provide weak, ineffective, or nonexistent property (including intellectual property), human rights, labor, and environmental protections, and producers and suppliers in countries in which the governments provide and enforce such protections.'

international agreement such as an ILO convention or a MEA. At the same time, the enforcement could relate to introducing technical regulations and conformity assessment procedures for verifying compliance.¹¹⁰ Still, the EU in the Corporate Sustainability Reporting Directive does not directly connect the required minimum and common regulatory burden to an international instrument or standard.¹¹¹ These measures ensure that economic operations do not gain unfair advantages by operating under lighter regulatory burdens, evading compliance costs, or externalizing them.¹¹²

The panel in the EU–Korea FTA labour dispute adopted this view. It explained that the ‘floor’ of labour rights forms an integral component of the trade relations both parties have committed to upholding and enhancing.¹¹³ Domestic measures enforcing these commitments are integral to this LPF structure. Still, a breach of those commitments requires a certain level of trade effects (ie distortion of comparative advantage).¹¹⁴

Argentina raised similar LPF arguments in the WTO case *Argentina–Financial Services*, alleging that the differential treatment imposed was required to level the playing field for services suppliers from cooperative and non-cooperative jurisdictions.¹¹⁵ The former faced higher compliance costs than the latter, creating an unfair disadvantage due to regulatory divergences.

In a similar manner, the concept of competitive neutrality in SOE regulation reflects the requirement that all entities bear a similar regulatory burden notwithstanding their ownership status. SOEs should not benefit from preferential treatment within the domestic regulatory landscape, whether through affirmative actions like subsidies or exceptions from regulations.¹¹⁶ For this reason, the requirement of aligning SOEs’ commercial operations with non-discrimination principles is similar to established competition law norms, such as non-discrimination obligations for dominant entities or restrictions on vertical practices.¹¹⁷

The following conclusions may be drawn:

- A necessity test is required in instances of positive intervention, such as providing subsidies. Otherwise, the intervention is considered unfair and, thus, prohibited by LPF measures.
- An efficiency analysis is conducted in cases of enforcement, such as active enforcement or rebalancing measures. An otherwise unfair practice may prove more beneficial than introducing a remedy, or a fair practice may require rebalancing to ensure LPF.

¹¹⁰ An illustrative example of such approaches is the following quote on the US approach in NAFTA negotiations: ‘[t]he Administration is not seeking guidelines on the level of minimum wages, nor health and safety standards that are not appropriate to a country’s level of development But at the same time, no country should seek to gain or maintain a comparative advantage or otherwise distort competitive conditions by maintaining artificially low labor or environmental standards’ (found in: Robert E Hudec, ‘Differences in National Environmental Standards: The Level-Playing-Field Dimension’ (1996) 5 *Minnesota J Int Law* 1, 23).

¹¹¹ Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting OJ L 322.

¹¹² Michael Trebilcock and Robert Howse, ‘Trade Liberalization and Regulatory Diversity: Reconciling Competitive Markets with Competitive Politics’ (1998) 6 *Eur J Law Econ* 187.

¹¹³ *EU–Korea Free Trade Agreement Labor Dispute*. The Panel even made a differentiation from the US–Guatemala dispute which did not encompass such an extensive floor of labour rights, as the Dominican Republic–Central America–United States Free Trade Agreement ‘does not have the same contextual setting of sustainable development as the EU–Korea FTA, nor does it refer to the range of multilateral and international agreements and declarations which the Parties have included in the EU–Korea FTA’ [para 93].

¹¹⁴ *ibid* para 196; Claussen (n 84) 36.

¹¹⁵ WTO Appellate Body Report, *Argentina—Measures Relating to Trade in Goods and Services*, WT/DS453/AB/R, adopted 9 May 2016, para 7.507.

¹¹⁶ Ines Willems, ‘Disciplines on State-Owned Enterprises in International Economic Law: Are We Moving in the Right Direction?’ (2016) 19 *J Int Econ Law* 657; Ming Du, ‘China’s State Capitalism and World Trade Law’ (2014) 63 *Int Comp Law Quart* 409.

¹¹⁷ Eg Guidelines on Vertical Restraints, European Commission, OJ C 130, 19 May 2010, paras 121, 175; Renato Nazzini, ‘Exclusionary Abuses’ in Barry Rodger (ed), *The UK Competition Regime: A Twenty-Year Retrospective* (Oxford University Press 2021) 79.

- In matters of externalities, achieving LPF involves state intervention to ensure a common minimum standard of regulatory burden. This might involve setting minimum standards, restricting or prohibiting certain practices, or introducing pricing mechanisms to prevent trade distortions.

Taxonomy of LPF measures

Table 1 provides a few key illustrative examples of LPF measures and their classification in our mapping exercise, in accordance with the taxonomy introduced.

LPF AS A GUIDELINE FOR INCORPORATION OF TRADE AND NON-TRADE CONCERNS IN TRADE MEASURES

The mapping exercise depicted the modalities, considerations, and elements of LPF measures. Functioning within the normative landscape of IEL, the concept of LPF aims to standardize approaches for assessing the positive and negative impacts of regulations and state intervention in trade and sustainability policy. Nevertheless, these measures should not aim to equate all relevant regulatory conditions but only those identified as unfair. Otherwise, the concept of LPF, especially when introduced unilaterally, would be simply considered a synonym for protectionism.

Where do LPF measures draw the line between fair and unfair trade?

LPF measures do not seek to impose identical regulatory costs and regulations; they allow for regulatory divergence as long as minimum standards ('floors and ceilings') are satisfied.

First, a particular and strict 'floor' are certain minimum international norms, such as forced and child labour. A breach of or non-compliance with these norms is considered unfair trade per se, even without quantifiable trade effects.

For other non-trade concerns, the need for quantifiable trade effects is the first substantive 'ceiling'. Not every regulatory cost divergence or difference should be levelled, but only those that distort competitive conditions. This varies between different types of regulations, market actors, and geographical locations. An important requirement is that these regulatory divergences be linked to international norms (such as ILO conventions) or international public goods (eg stable climate). Each state can impose its own level of protection of public goods. If this results in injurious free-riding, however, then LPF measures are deployed. Indeed, many LPF measures are introduced precisely due to the inaction of trading partners. In bilateral accords, the parties can set the minimum level of regulatory ambition, below which an unfair advantage exists.

Certain lines have been drawn in practice. For instance, there is growing consensus on the minimum number of ILO conventions and MEAs a country should ratify and effectively enforce to preserve LPF.¹¹⁸ Some consistency has also arisen on what LPF means in subsidy provision¹¹⁹ and in timber and anti-deforestation regulation.¹²⁰ In contrast, CBAMs or SOEs regulations face significant divergences in defining 'floors and ceilings.'¹²¹ Whether LPF will constitute a customized comparative advantage concept that promotes free trade or the *nouvelle vague* of

¹¹⁸ Granger and Siroën (n 93). Gradually even for Asian countries: Yueming Yan, 'Labour and Trade in Asia Pacific: Origin, Development, and Prospects' (2023) 31 Asia Pac Law Rev 576. See the rise of forced labour regulation mentioned (n 80).

¹¹⁹ Similar concepts in EU and UK state aid and subsidy control (Canada considers introducing similar concepts), while the USA seems to join this approach with the Inflation Reduction Act. Further, there is growing coherence in developed countries proposal for subsidies regulation, eg Joint statement of the ministers of USA, Japan, and EU on trilateral cooperation (30 November 2021).

¹²⁰ The EU, the UK, the USA, Japan, and China have introduced timber and anti-deforestation regulations.

¹²¹ Significant differences in emissions calculation and baselines, while the SOEs regulation of the USA is significantly different from the EU since the USA focuses on the total removal of state advantages while the EU exercises a balancing exercise of public interests.

Table 1. Taxonomy of LPF measures.

Name of measure	Introduction method	Enforcement method	Level of harmonization	Remedies type	Source of unfairness	LPF standard
Foreign Subsidies Regulation	Unilateral	Active	N/A	Pricing	Governmental (with private)	Efficiency Approach
Non-Regression Provisions in PTAs	Plurilateral	Active	Minimum Standard	Prohibition (with possibility of pricing)	Governmental	Externalities Approach
Mirror Provisions in PTAs	Plurilateral	Passive	Equivalent standards (or identical)	Prohibition	Governmental (with private)	Externalities Approach
Anti-Deforestation Regulations	Unilateral	Passive	Minimum Standard	Prohibition	Private (with governmental)	Externalities Approach
Subsidies Provisions in PTAs	Plurilateral	Active	Minimum Standard	Prohibition	Governmental	Liberal Approach
State Aid Provisions in PTAs	Plurilateral	Active	Identical Standards	Pricing	Governmental	Efficiency Approach
Anti-dumping with Sustainability Considerations	Unilateral	Active	Minimum Standard	Pricing	Private (with governmental)	Externalities Approach
Forced Labor Measures	Unilateral	Passive	Minimum Standard	Prohibition	Private	Externalities Approach
CBAMs	Unilateral	Active	Equivalent standards	Pricing	Private (with governmental)	Externalities Approach

developed countries' protectionism depends on how the lines are drawn with regard to a transnational LPF that provides fair chances to market actors from developing and least developed countries.¹²²

The integration of sustainability concerns in traditional trade measures provides not only positive leeway for further streamlining the need for achieving sustainability goals but may also constitute an effective way to maximize positive externalities and minimize negative externalities that accompany international trade.¹²³ Evidence of fundamental changes in labour and environmental legislation and standards in developing countries linked to trade conditionalities has started to emerge.¹²⁴ Similar evidence of harmonization and increased regulatory capacity have been identified in competition law of non-EU countries related to similar LPF obligations found in Association Agreements with the EU.¹²⁵

Rise of unilateralism and LPF: protectionism re-introduced?

LPF has mostly been associated with the rise of unilateral measures, whose effects and motives may be mixed. However, protectionist measures introduced under the façade of an LPF should be avoided, as this will further undermine the liberal trading system.¹²⁶

Unilateral measures are often criticized as protectionist tools developed countries use to safeguard particular sectors from foreign competition, further tilting an already uneven playing field.¹²⁷ For example, proponents advocating for higher environmental or labour standards might employ the LPF narrative to protect local interests against foreign competition.¹²⁸ Therefore, it becomes imperative to scrutinize the sincerity of economic or sustainability considerations, distinguishing between authentic aims and an agenda to elevate protection against foreign competition.¹²⁹ Evaluating the effects of trade on sustainability and vice versa is crucial when delineating the aforementioned 'floors and ceilings'.¹³⁰

Hence, a measure like CBAM should account for both the impact on the relative carbon neutrality commitment and the extent of carbon leakage (eg in the (re)location of production processes in 'polluter havens')¹³¹ when implementing the relevant duty or other redressive measure. If CBAM remains true to its objective, it should serve as a competition and a climate change measure. Its aim should be to prevent competitive distortions arising from differences in regulatory standards related to climate policy while concurrently reducing carbon leakage and encouraging low-impact production methods to establish a new source of *fair*, competitive

¹²² See the attempts for common principles: 'The Villars Framework' <<https://remakingtradeproject.org/villars-framework>> accessed 18 July 2024 and International Legal Expert Group on Trade-Related Climate Measures and Policies, 'Principles of International Law Relevant for Consideration in the Design and Implementation of Trade-Related Climate Measures and Policies' (Report of an International Legal Expert Group. Forum on Trade, Environment, & the SDGs, 2023).

¹²³ Michael E Porter and Claas van der Linde, 'Toward a New Conception of the Environment-Competitiveness Relationship' (1995) 9 *J Econ Perspect* 97, 97.

¹²⁴ International Labour Organization (ed), *Social Dimensions of Free Trade Agreements* (Studies on growth with equity, International Labour Organization 2013); Kimberly Ann Elliott and Richard B Freeman, *Can Labor Standards Improve under Globalization?* (Institute for International Economics 2003); Alisa Dicaprio and Amelia U Santos-Paulino, 'Can Free Trade Agreements Reduce Economic Vulnerability?' (2011) 79 *S Afr J Econ* 350.

¹²⁵ Michal S Gal, 'The Cut and Paste of Article 82 of the EC Treaty in Israel: Conditions for a Successful Transplant' (2007) 9 *Eur J Law Reform* 467; Solomon Menabdishvili, 'Recent Developments in the Competition Law of Georgia. Changes Resulting from the Association Agreement' (2015) 8 *Yearb Antitrust Regul Stud* 213; Pablo Ibáñez Colomo and Damien J Neven, 'The Extraterritorial Dimension of EU State Aid Control' (SSRN Scholarly Paper, 3 February 2023).

¹²⁶ See Irwin (n 14) 251; José Manuel Salazar-Xirinachs and Jorge Mario Martínez-Piva, 'Trade, Labour Standards and Global Governance: A Perspective from the Americas' in Stefan Griller (ed), *International Economic Governance and Non-Economic Concerns*, vol 5 (Springer 2003); Robert M Stern, 'Labor Standards and Trade Agreements' [2003] Working Papers 496.

¹²⁷ Similar in Claussen (n 84).

¹²⁸ See Hudec (n 110) 5.

¹²⁹ Sean D Ehrlich, 'The Fair Trade Challenge to Embedded Liberalism' (2010) 54 *Int Stud Quart* 1013.

¹³⁰ Durán (n 84) 1064–67.

¹³¹ Arik Levinson, 'Environmental Regulations and Manufacturers' Location Choices: Evidence from the Census of Manufacturers' (1996) 62 *J Public Econ* 5.

advantage. The focus should not be solely on the specific form of the measure but on whether the particular externality is otherwise addressed in the relevant national jurisdiction.

Consequently, the emphasis should not be on mandating producers to pay identical carbon taxes or adhere to the same regulatory scheme, like an Emissions Trading Scheme, which in the past were considered rigid and protectionist requirements under WTO jurisprudence (such as *US-Shrimp*).¹³² Additionally, LPF measures should prioritize promoting greater efficiency through innovation and improvement rather than preserving a stagnant perception of competitive advantage protected by regulatory measures. The most competitive market players adjust to changing conditions and innovate, rather than merely relying on cheaper inputs and PPMs.

Similar reasoning applies to regulations. If a country possesses certain physical or regulatory advantages, enabling it to achieve the same environmental standards with less strict or costly regulations, then compensating for this through a remedial measure that equalizes carbon tax payments might not be justified.¹³³ Not all costs must be equalized, as this would nullify the need for international trade.¹³⁴

In general, implementing LPF measures, especially unilaterally, requires a comprehensive assessment of the theory of harm. This assessment should consider the gravity and nature of 'unfairness' and evaluate its intensity concerning trade effects.¹³⁵ Similarly, positive externalities and sustainability impacts should be weighed against their negative trade consequences according to a *rule of reason*.

On the one hand, a higher convergence of regulatory burdens, irrespective of trade effects, may be mandated to enforce global norms and standards, like a core ILO convention. When examining the application of global norms, it is crucial to apply principles such as the Common but Differentiated Responsibilities to modulate the required convergence.

Conversely, lower convergence may be required for conditions and measures with minimal trade effects.¹³⁶ Nevertheless, not every regulation may be subject to convergence; a market failure resulting from an inadequate regulatory response in other markets is a potential factor. The latter scenario suggests that a global externality, such as a global public good, exists unaddressed by a first-best domestic response.¹³⁷ The capacity to distort may be linked to the level of integration or proximity of the country of origin with the relevant market, the size of the market actor or its supply chain, and the nature of the 'unfair' divergence.

In essence, LPF entails intervening in free trade solely when necessary, either by introducing a subsidy to address a market failure or by recalibrating situations involving either a net negative subsidy or substantial regulatory divergences. These divergences could result either from failing to uphold a globally accepted norm or from an appropriate regulatory response in other markets to rectify a market failure. The latter scenario demands a global externality, linked to a global public good, that remains unremedied or inadequately addressed by the first-best response at the source level.

¹³² Similar analysis has been made with regards to the different aspects of labour and trade policy. More in: Billy Melo Araujo, 'Labour Provisions in EU and US Mega-Regional Trade Agreements: Rhetoric and Reality' (2018) 67 *Int Comp Law Quart* 233; Erika de Wet, 'Labor Standards in the Globalized Economy: The Inclusion of a Social Clause in the General Agreement On Tariff and Trade/World Trade Organization' (1995) 17 *Hum Rights Quart* 443.

¹³³ See Hudec (n 110) 21–22.

¹³⁴ However, proponents of both the 'new' trade theory and the 'new new' trade theory contend that trade persists even when producers encounter comparable costs and prices. This persistence is attributed to the inherent 'preference for variety' among global consumers, driving international trade despite similarities in prices, as goods are differentiated, not identical, Paul Krugman and others, *International Trade: Theory and Policy, Global Edition* (12th edn, Pearson 2022); Sergey Kokovin and others, 'Increasing Returns, Monopolistic Competition, and International Trade: Revisiting Gains from Trade' (2022) 137 *J Int Econ* 103, 595; Ralph Ossa, 'Profits in the "New Trade" Approach to Trade Negotiations' (2012) 102 *Am Econ Rev* 466.

¹³⁵ For instance, in the law of countermeasures, the appropriateness of a response is linked both to quantitative and qualitative criteria [*Air Services Agreement Case (France v United States)*, Award, 54 *ILR* 303, para 91]. Trade restrictiveness as a qualitative and quantitative assessment is similar [Brazil—Tyres (n 104) para 145].

¹³⁶ These considerations are incorporated in the notion of 'graded LPF'.

¹³⁷ RG Lipsey and Kelvin Lancaster, 'The General Theory of Second Best' (1956) 24 *Rev Econ Stud* 11.

CONCLUSION

LPF constitutes an important change to the traditional understanding of free trade and the balance within the WTO system. As a concept, LPF integrates trade and non-trade concerns and the regulation of state intervention with a goal of promoting fairer and more efficient trade outcomes that also facilitate the sustainable development agenda. However, LPF does not provide *carte blanche* for developed countries to export their trade and non-trade preferences to the Global South.

LPF in sports requires introducing a line between fair advantages (eg talent) and unfair ones (eg drug usage), providing all participants the opportunity for success. In IEL, the concept of LPF requires deference in favour of actors from developing and least developed countries since their capacity to distort trade flows (and, to an extent, to negatively impact global public goods) is lower. The imposition of similar regulatory compliance costs entails a degree of variation between the imposed standards and requirements based on the gravity and intensity of the regulatory divergence and its impact on compliance costs across the relevant supply chains.