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PRESHIPMENT INSPECTION

Background Note by the Secretariat

Addendum

In April 1988 the secretariat circulated a note on preshipment inspection which gave some background information on the subject and summarized relevant discussions that had taken place within the framework of the GATT and the multilateral trade negotiations (MTN.GNG/NG2/W/11). At its meeting of 19 May 1989, the Negotiating Group requested the secretariat to prepare a note to bring this document into line with notes on other subjects, by outlining any relevant provisions in the GATT and other international agreements (MTN.GNG/NG2/10, paragraph 14). This addendum takes into account points made in the discussions that have already taken place on this subject.

I. Relevant GATT provisions

This paper examines some of the main questions on the relationship between preshipment inspection mandated by governments and GATT provisions. Preshipment inspection is used by different governments in different ways, but in order to avoid making the discussion overly burdensome, the paper does not address every such practice. Nor does it pronounce on the practices of any individual government.

It is recalled that only the CONTRACTING PARTIES can make definitive interpretations of the General Agreement. The points set out below are, therefore, intended only as a contribution to discussions on the questions which they raise.

It should be borne in mind that all governments employing preshipment inspection are developing countries. This paper therefore pays particular attention to GATT rules for developing countries.

Question 1. To what extent are GATT provisions relevant to preshipment inspection?

There are two sets of requirements involved in preshipment inspection: (a) those of the government itself, such as presentation of a clean report

of findings as a condition of customs clearance; and (b) those which the government mandates preshipment inspection companies to carry out on its behalf, namely the inspection process itself.

The first set of requirements are evidently governmental and therefore clearly fall within the scope of the General Agreement, to the extent that such requirements are addressed by its provisions.

To answer the question of GATT relevance to the second set of requirements, it is necessary to ask whether they are or not governmental measures. There are a number of precedents in the GATT which throw light on this issue. These relate to different articles of the General Agreement and are summarized in the report of the panel on "European Economic Community - Restriction on Imports of Dessert Apples" (L/6491, pages 39-40). A 1960 Panel, examining the question of whether subsidies financed by non-governmental levy were notifiable under Article XVI, expressed the view that "... the question ... depends upon the source of the funds and the extent of government action, if any, in their collection" (Report of the Panel on "Review pursuant to Article XVI:5" (BISD 9S/192)). Another Panel found that the informal administrative guidance used by the Japanese Government to restrict production of certain agricultural products could be considered to be a governmental measure within the meaning of Article XI:2 because it emanated from the Government and was effective in the Japanese context (Report of the Panel on "Japan - Restrictions on Imports of Certain Agricultural Products" (L/6253, page 79)). A third Panel considered that legally non-mandatory measures could constitute restrictions within the meaning of Article XI:1 if "sufficient incentives or disincentives existed for non-mandatory measures to take effect ... [and] the operation of the measures ... was essentially dependent on Government action or intervention [because in that case] ... the measure would be operating in a manner equivalent to mandatory requirements such that the difference between the measures and mandatory requirements was only one of form and not of substance" (Report of the Panel on "Japan - Trade in Semi-Conductors" (L/6309, p.40)).

The Apple panel then went on to find that the EEC internal régime for apples was a hybrid one, combining elements of public and private responsibility, that there were two possible systems, direct buying-in of apples by Member State authorities and withdrawals by producer groups, and that under the system of withdrawals by producer groups, which was the EEC's preferred option, the operational involvement of public authorities was indirect. The Panel then concluded that because "the régime as a whole was established by Community regulations which set out its structure" and "its operation depended on Community decisions ... both the buying-in and withdrawal systems could be considered to be a governmental measures" (L/6491, page 40).

It therefore seems clear that preshipment inspection requirements mandated by government, the operation of which depends on the actions of the government, would be considered to be government measures for the purposes of the GATT.

Question 2. Can government requirements that a clean report of findings be presented in order to clear customs give effect to import restrictions within the meaning of Article XI?

A clean report of findings may be a necessary condition for the customs clearance of imports.

For instance, in order to combat fraud, governments of importing countries may require a preshipment inspection company to check the quantity and quality of import shipments against the terms of the contract in order to establish whether these have been observed. Governments may also provide that the submission of a clean report of findings by the preshipment inspection firm, stating that the quantity and quality of the goods correspond to those set out in the contract, is a necessary condition for the customs clearance of the goods.

Governments whose aim is also to ensure that the price paid for imports is not too high and to guard against loss of foreign exchange associated with over-invoicing, may also require the preshipment inspection company to check the price of shipments and determine whether it corresponds to prices generally charged. In this case, governments may provide that a clean report of findings which also states that the price of the imports is no higher than those generally charged is necessary for customs clearance.

In practice, governments using preshipment inspection often combine this requirement with import licensing systems.

It seems clear that a government requirement, that imported goods will only be cleared through customs if accompanied by a clean report of findings, entails a prohibition of imports in respect of which a clean report of findings is not granted, contrary to the general ban on quantitative restrictions contained in Article XI:1 of the General Agreement. The same would, of course, apply to any import documentation (e.g. legalized commercial invoices, certificates of origin) presentation of which is mandatory for customs clearance (see also Question 9 below).

It should be noted, however, that measures which are contrary to Article XI may be justified by exceptions to that Article. These are the subject of Question 4.

Question 3. Can government requirements that goods be inspected give effect to import restrictions within the meaning of Article XI?

It has also been argued that delays, additional costs and unjustifiable reductions in prices contained in freely negotiated contracts, caused by the inspection process itself, constitute restrictions on trade.

The question here is whether past practice provides any criterion that could be used to determine whether the effects of preshipment inspection referred to above are significant enough to constitute import restrictions. Two GATT dispute settlement cases have established that procedures which resulted in delays in the granting of licences could constitute restrictions inconsistent with Article XI:1. The panel report on EEC - programme of minimum import prices, licences and surety deposits for certain processed fruits and vegetables considered that a delay of five days in granting import certificates constituted automatic licensing, which was not contrary to Article XI:1 (BISD, 25S, paragraph 4.1 on page 95; adopted by the Council, C/M/128, page 4). The report on Japan - Trade in Semi-Conductors considered that the standard applicable to import licences should be applied also to export licences and concluded that delays of up to three months in the issuing of export licences constituted restrictions inconsistent with Article XI:1 (L/6309, paragraphs 118 and 132:B; adopted by the Council, C/M/220, page 25). While both these cases involve delays in the granting of licences, there would seem to be no reason to assume that delays in the granting of a clean report of findings required by governments for customs clearance would not also be regarded as restrictions within the meaning of Article XI.

It should be noted, however, that measures which are contrary to Article XI:1 may be justified by one or other of the exceptions to that provision. These are the subject of the next question.

Past cases give little specific guidance as to whether the other effects complained of, e.g. any resulting reductions in contract prices, constitute restrictions on imports.

Question 4. Are there provisions in the General Agreement that would justify import restrictions related to preshipment inspection mandated by governments?

It may be argued that most restrictions which preshipment inspection mandated by governments may entail are authorized by Article XVIII:B since all the governments concerned are of developing countries and inspection is frequently applied, "in order to safeguard [their] external financial position and to ensure a level of reserves adequate for the implementation of [their] programme of economic development" (Article XVIII:9). It should be noted in this context that in one case, that of Peru, a preshipment inspection scheme was examined in the Committee on Balance-of-Payments Restrictions (see BOP/R/173, paragraphs 21-22).

Article XVIII:B allows a developing country with balance-of-payments problems to "control the general level of its imports by restricting the quantity or value of merchandise permitted to be imported" (Article XVIII:9). Some doubt may be expressed as to whether preshipment inspection does in fact do this, since preshipment inspection is not designed to limit the general level of imports. It might therefore be

argued that Article XX:(d), which is dealt with below, is a more appropriate justification. In any case, governments wishing to justify such measures by this provision, must meet the conditions which it contains. Substantive conditions include the following. The measures shall not exceed those necessary to achieve the objectives referred to above (paragraph 9). While the measures may give priority to imports of products which are more essential to their economic development, they shall be so applied as to avoid unnecessary damage to the commercial or economic interests of other contracting parties (paragraph 10). In carrying out their domestic policies, governments maintaining the measures shall pay due regard to the need for restoring equilibrium in their balance-of-payments on a sound and lasting basis (paragraph 11). Procedural conditions include the following. Governments maintaining the measures shall consult every two years with the CONTRACTING PARTIES in the Balance-of-Payments Committee as to the nature of their balance-of-payments difficulties, alternative corrective measures which may be available and the possible effects of the restrictions on the economies of other contracting parties (paragraph 12). These governments must also satisfy the conditions laid down in Article XIII on the non-discriminatory administration of quantitative restrictions, subject to the exceptions to these rules contained in Article XIV.

A Declaration adopted by the CONTRACTING PARTIES on 28 November 1979, also subjects the application of all restrictive import measures taken for balance-of-payments purposes to a number of conditions in addition to those laid down in Article XVIII. It provides that governments applying such measures shall give preference to the measure which has the least disruptive effect on trade (on the understanding that the less-developed contracting parties must take into account their individual development, financial and trade situation when selecting the particular measure to be applied), should avoid the simultaneous application of more than one type of trade measure and, whenever practicable, shall publicly announce a time schedule for the removal of the measures (BISD,26S, paragraph 1 on page 206). On the procedural side, the Declaration provides that all restrictive import measures taken for balance-of-payments purposes shall be subject to consultation in the Balance-of-Payments Committee (BISD,26S, paragraph 4 on page 207).

Article XX(d) is another provision which might be invoked to justify restrictions entailed by preshipment inspection. This provision permits import restrictions "necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of [the General] Agreement, including those relating to customs enforcement ... and the prevention of deceptive practices". Governments invoking this provision should therefore be prepared to cite the law or regulation in question, to demonstrate that it is consistent with the provisions of the General Agreement and that the import restrictions are necessary to secure compliance with it. It may, for instance, be argued that preshipment inspection is necessary to ensure compliance with balance-of-payments restrictions. In addition, this exception is subject to the condition that

the restrictions "are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade" (Article XX, introduction).

Finally, measures applied in conjunction with exchange restrictions may be defended by invoking Article XV:9(b), which provides that nothing in the General Agreement precludes the use by a contracting party of restrictions or controls on imports or exports, the sole effect of which, additional to the effects permitted under Articles XI, XII, XIII and XIV, is to make effective exchange controls or exchange restrictions applied in accordance with the Articles of Agreement of the International Monetary Fund. It may be noted in passing that Article XVIII is not on the list of GATT provisions in this paragraph but that this may simply be because no-one thought of adding the reference to it when Article XVIII was drafted at the Review Session in 1955.

It will be noted from the above analysis that one of the main substantive ideas behind each of these exceptions to Article XI is that the import restrictions in question should not be more restrictive than necessary to achieve their legitimate objectives.

Question 5. Do GATT rules apply to government requirements that a clean report of findings be presented in order to obtain foreign exchange?

Governments may provide that a clean report of findings, stating that the price of the imports is not too high, is a necessary condition for obtaining the foreign exchange to pay for the imports. It is also possible to envisage a case in which a clean report of findings is necessary to obtain both foreign exchange and an import licence. The effects on trade of such a measure would be very similar to those of a price verification procedure necessary for customs clearance. However, they would be the result of conditions regulating the release of the foreign exchange required to pay for imported goods rather than conditions directly governing the importation of the goods themselves.

In such a case two questions need to be answered. Is the measure a trade measure? If it is an exchange measure, do any GATT rules apply?

The CONTRACTING PARTIES have never formally drawn a dividing line between trade and exchange measures. However, one of the reports adopted at the Review Session in 1955 noted "the fairly clear division of work between the IMF on the one hand and the CONTRACTING PARTIES to the GATT on the other based on the technical nature of governmental measures rather than on the effect of these measures on international trade and finance" (BISD, 3S/196). The IMF has concluded that only a definition based on the technique used, and not on the effects of a measure, is unambiguous: "The guiding principle in ascertaining whether a measure is a restriction on

payments and transfers for current international transactions....is whether it involves a direct governmental limitation on the availability of exchange as such." (Executive Board Decision No. 1034-(60/27) of 1 June 1960).

It should be noted that, if it is accepted that the requirement by the government that the submission of a clean report of findings as a necessary condition for obtaining foreign exchange is an exchange measure, the physical inspection of the goods remains a trade measure and might give effect to trade restrictions. Furthermore, there may be cases where the clean report of findings is required for obtaining not only the necessary foreign exchange to pay for the goods but also the licence to import them. In these respects the discussion of earlier questions is relevant.

If, and to the extent that, the government requirement of a clean report of findings is an exchange measure, then the following GATT provisions apply.

Article XV:9(a) of the General Agreement provides that: "Nothing in this Agreement shall preclude the use by a contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund....". Paragraphs 4 and 5 of the same Article provide, however, that "contracting parties shall not, by exchange action, frustrate the intent of the provisions of [the General] Agreement" and that "if the CONTRACTING PARTIES consider, at any time, that exchange restrictions on payments and transfers in connection with imports are being applied by a contracting party in a manner inconsistent with the exceptions provided for in this Agreement for quantitative restrictions, they shall report thereon to the Fund."

The General Agreement nevertheless does contain provisions imposing conditions on the international transfer of payments. The general most-favoured-nation clause contained in Article I:1 applies, inter alia, to "charges of any kind ... imposed on the international transfer of payments for imports ... and the method of levying such ... charges" and to "rules and formalities in connection with importation ...". The publication requirement of Article X:1 applies to "laws, regulations, judicial decisions and administrative rulings of general application ... pertaining to ... the transfer of payments [for imports]."

In practice the CONTRACTING PARTIES have on a number of occasions taken the position that "measures restricting payments could have a trade impact and should therefore not be ignored by the GATT" (BOP/R/119, paragraph 8). This position was, for instance, taken in the consultations held in the Committee on Balance-of-Payments Restrictions on an Italian deposit requirement for purchases of foreign currency (BOP/R/119) and on a Yugoslavian exchange allocation system (BOP/R/122). In these cases, the Committee examined the measures and made recommendations to the governments concerned.

Question 6. Can the GATT provisions on valuation apply to mandatory price verification?

To ensure that customs duties are collected in full, governments may require the preshipment inspection company to verify the value of imports to be used as a basis for levying customs duties. The governments may stipulate that the price in the clean report of findings must be accepted as the value on which duties are assessed, without the contract price of the goods inspected being affected.

Governments wishing to guard against over-invoicing may also require that the preshipment inspection company verify the value of imports and that a clean report of findings be presented for customs clearance.

The first paragraph of Article VII specifically states that contracting parties "undertake to give effect to such principles in respect of all products subject to duties or other charges [excluding internal taxes or equivalent charges imposed on or in connection with imported products] or restrictions on importation and exportation based upon or regulated in any manner by value". The wording of this provision makes it clear that contracting parties employing preshipment inspection companies in connection with customs valuation (the first case above) have an obligation to ensure that these principles are observed. The last phrase, relating to restrictions "based upon or regulated in any manner by value", would appear to extend the provisions of Article VII also to the second case above.

Article VII:2 to 5 (including the notes to Article VII:2) set out the general principles of valuation accepted by contracting parties. Paragraph 5 of the Article also lays down that the bases and methods for determining values "should be stable and should be given sufficient publicity to enable traders to estimate, with a reasonable degree of certainty, the value for customs purposes." This means that contracting parties have an obligation to ensure that such publicity is given to the "bases and methods used by preshipment inspection companies".

In addition, Article II:3 lays down that "no contracting party shall alter its method of determining dutiable value or of converting currencies so as to impair the value of any of the [tariff] concessions provided for in the appropriate schedule annexed to this Agreement". Contracting parties have thereby undertaken to ensure that the hiring of a preshipment inspection company for valuation purposes does not lead to such changes.

The most-favoured nation provisions in Article I:1 of the General Agreement apply, inter alia, to the method of levying customs duties and charges of any kind imposed on or in connection with importation.

It may be argued that Article XX:d is also relevant.

CONTRACTING PARTIES having accepted the Agreement on Implementation of Article VII have an obligation to abide by the detailed rules on customs valuation which it contains.

Question 7. Is the regulation of the activities of inspection companies in exporting countries an export restriction?

Governments sometimes regulate the inspection of exports on their territory by preshipment inspection companies mandated by governments of importing countries either by prohibiting inspection by companies mandated by governments or by laying down conditions under which such inspection can be carried out.

It is a general principle of international law that a state may not take governmental measures in the territory of another state and governments may therefore enforce that general principle through the regulation of the activities of preshipment inspection companies acting on behalf of a foreign government.

The aim of governments regulating the activities of preshipment inspection companies on their territories is to facilitate exports, and no complaints seem to have been made that the regulation of these activities have the perverse effect of creating restrictions on exports. However, it should be noted that Article XI:1 prohibits "restrictions ... on the exportation or sale for export of any product destined for the territory of any other contracting party" and that in the present context the prohibition of restrictions on sale for export may be particularly relevant. There are fewer exceptions to the prohibition of restrictions on the export side than on the import side but, as already noted, Article XX:(d) permits "measures ... necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement ...".

There are no provisions in the General Agreement itself setting out agreed terms and conditions under which inspections mandated by one contracting party can be carried out on the territory of another. However, Article 6:5 of the Tokyo Round Agreement on Implementation of Article VI of the GATT, the text of which was taken over from the Kennedy Round Anti-Dumping Agreement, provides that "in order to verify information [relevant to anti-dumping investigations] provided or to obtain further details the authorities may carry out investigations in other countries as required, provided they notify the representatives of the government of the country in question and unless the latter object to the investigations". A recommendation concerning on-the-spot investigation adopted by the Committee on Anti-Dumping Practices in 1983 sets out procedures for the implementation of this provision (BISD, 30S/28-29).

Question 8. Which GATT rules apply to mandatory verification by preshipment inspection companies of conformity with technical regulations?

Governments may require, as a condition for customs clearance, a clean report of findings stating that the goods are in conformity with technical regulations adopted, e.g. for health and safety purposes, which prohibit the sale of goods that do not conform to specific standards, whether these goods are of national origin or whether they are imported.

The main GATT provision on technical regulations is Article III, and in particular its paragraphs 1 and 4, which lay down that imported goods be accorded treatment no less favourable than that of like products of national origin. A note to that Article makes it clear that, even if the regulation is enforced in the case of imported products at the time or point of importation, the regulation is still subject to the provisions of the Article. It might be argued that a mandatory requirement that a clean report of findings be presented to customs as evidence of compliance with technical regulations as a condition for clearing customs also entails a prohibition of imports of goods which do not conform with the technical regulations and that Article XI:1, and its exceptions, apply in addition to Article III.

Question 9. Do GATT rules on fees and formalities apply to mandatory preshipment inspection?

Article VIII:1(a) provides that "all fees and charges of whatever character (other than import ... duties and other than taxes within the scope of Article III) imposed by contracting parties on or in connexion with importation ... shall be limited to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports ... for fiscal purposes." Other paragraphs deal with the simplification of import formalities.

It seems clear that, if governments make inspection mandatory, Article VIII would apply. Paragraph 4(g) of that Article explicitly states that the provisions of the article "shall extend to fees, charges, formalities and requirements imposed by governmental authorities in connexion with importation ..., including those relating to ... analysis and inspection."

Question 10. Are government requirements relating to preshipment inspection subject to GATT provisions on transparency and administration of trade regulations?

Article X, on "Publication and Administration of Trade Regulations", extends inter alia to "laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to ... the valuation of products for customs purposes ... or to requirements, restrictions or prohibitions on imports, ... or on the transfer of payments therefor or affecting their ... inspection, ...".

Paragraph 1 of Article X provides that such regulations, "shall be published promptly in such a manner as to enable governments and traders to become acquainted with them". Paragraph 2 provides that measures shall not be enforced before such official publication.

Paragraph 3(a) of Article X may also be relevant. This provides for the uniform and impartial administration of government laws, regulations, decisions, rulings of the kind described in paragraph 1 of the Article. Paragraph 3(b) provides that "each contracting party shall maintain, or institute as soon as practicable, judicial, arbitral or administrative tribunals or procedures for the purpose, inter alia, of the prompt review and correction of administrative action relating to customs matters" and that "such tribunals or procedures shall be independent of the agencies entrusted with administrative enforcement ...".

Question 11. Do GATT provisions relating to dispute settlement apply to mandatory preshipment inspection?

Article XXII provides for consultation "with respect to any matter affecting the operation of [the General] Agreement", and could be invoked to deal with issues relating to mandatory preshipment inspection.

Article XXIII sets out dispute settlement procedures in cases where "any contracting party should consider that any benefit accruing to it directly or indirectly under [the General] Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded" and could be invoked by contracting parties which consider that preshipment inspection made mandatory by governments has caused nullification or impairment of benefits.

II. Relevant provisions in other international agreements

A. International Monetary Fund (IMF)

The Articles of Agreement of the IMF provide that no restrictions shall be imposed, without Fund approval, on the making of payments and transfers for current international transactions (Article VIII:2(a)). The Fund will grant approval for restrictions only where it is satisfied that the restrictions are necessary for balance-of-payments reasons and that their use will be temporary while the member is seeking to eliminate the need for them. Approval is less likely to be granted for restrictions imposed for reasons not based on the balance of payments, because the Fund believes that the use of exchange systems for non-balance-of-payments reasons should be avoided to the greatest possible extent (Executive Board Decision No. 1034-(60/27) of 1 June 1960).

The Articles of Agreement also provide, however, an exception to this prohibition which is particularly important for many developing countries.

On assuming membership of the Fund, a country may avail itself of transitional arrangements under Article XIV which allow the maintenance and adaptation of restrictions on payments and transfers for current

international transactions that were in effect on the date on which it became a member, if such intention is notified to the Fund. The Fund may recommend the withdrawal of such restrictions as soon as conditions permit. In those cases, the Fund publishes a report annually on such restrictions. The Fund consults annually with members retaining restrictions inconsistent with Article VIII, and it may request their withdrawal if it deems conditions will allow it (Article XIV:3). A member that does not comply may be declared ineligible to use the general resources of the Fund (Article XXVI:2(a)).

Members are required to furnish such information to the Fund as the Fund deems necessary in the pursuance of its activities and duties, including information on exchange controls in operation at the time of assuming membership and subsequent changes as they occur (Article VIII:5:a(xi)). Such information should be as detailed and accurate as possible, taking into account members' varying ability to comply. But members are under no obligation to furnish information in such detail that the affairs of individuals or corporations are disclosed (Article VIII:5(b)).

B. Customs Cooperation Council (CCC)

No agreements have been adopted in the CCC governing preshipment inspection.

C. United Nations' Economic Commission for Europe (ECE)

Discussions have taken place, in recent years, under the aegis of the ECE's Working Party on Facilitation of International Trade Procedures. In 1981 the Working Party adopted Recommended Measure 8.2, as follows:

> "The present trend towards increased preshipment inspection of goods for purposes other than phytosanitary, sanitary and veterinary controls causes serious concern because of its implications in the form of costs and delays. This practice should be discouraged. When there is a legitimate need for inspection, the authorities concerned should accept certificates issued by official control bodies in the country of export."

At its March 1989 Session, the Working Party noted that the problems relating to preshipment inspection remained exceptionally resistant to normal facilitation techniques and the Working Party's usual approaches. It also acknowledged that the appropriate context in which to deal with the issue of preshipment inspection was the Uruguay Round of multilateral trade negotiations.