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GENERAL AGREEMENT ON TARIFFS AND TRADE

UNITED STATES - TRADE MEASURES AFFECTING NICARAGUA

Report by the Panel

1. Introduction

1.1 On 1 May 1985, the President of the United States of America issued an Executive Order prohibiting all trade with Nicaragua and transactions relating to air and sea transportation between Nicaragua and the United States with effect from 7 May 1985. The full text of the Executive Order is reproduced in paragraph 3.1 below. The United States informed the contracting parties of this action through a communication dated 7 May 1985 (L/5803). In a communication dated 6 May 1985 (L/5802 and Corr.1), Nicaragua asked for a special meeting of the Council to examine the measures imposed by the United States. The Council discussed the matter at its meeting of 29 May 1985 (C/M/188, pages 1-16). The Chairman of the Council proposed and the Council agreed that the Chairman would consult with the delegations to determine how the matter could be dealt with at a later Council meeting. In a communication dated 11 July 1985 Nicaragua requested the United States to hold bilateral consultations under Article XXII:1 of the General Agreement (L/5847). The United States did not agree to those consultations (C/M/191, page 41).

1.2 The Chairman informed the Council at its meeting of 17-19 July 1985 that his consultations had not resulted in a consensus on how to deal with the issue. The representative of Nicaragua said that in view of the lack of progress in the consultations held by the Chairman, his Government now asked for the establishment of a panel to review the case and to report to the CONTRACTING PARTIES. The representative of the United States objected to the establishment of a panel. His Government's actions against Nicaragua were covered by Article XXI:(b)(iii). This provision left it to each contracting party to judge what actions it considered necessary for the protection of its essential security interests. A panel could therefore not address the validity of, nor the motivation for, the United States' invocation of Article XXI:(b)(iii). The ultimate power of the CONTRACTING PARTIES under Article XXIII:2 was to authorize Nicaragua to suspend the application of its obligations under the General Agreement in respect of the United States. However, such a decision of the CONTRACTING PARTIES would be meaningless since the embargo covered also the United States' exports to Nicaragua. For these reasons, there was no practical function for a panel to perform in this

case. After having heard the Nicaraguan request, the United States' objections and the views of other contracting parties the Council agreed to authorize its Chairman to carry out consultations on possible terms of reference and the rôle of the panel requested by Nicaragua and to revert to the matter at its next meeting (C/M/191, pages 41-46).

1.3 At the meeting of the Council of 10 October 1985, the Chairman said that following his consultations with a number of interested parties, he could now report that the United States, while maintaining its position expressed at the July Council meeting, would not oppose the establishment of a panel provided it was understood that the Panel could not examine or judge the validity of or motivation for the invocation of Article XXI:(b)(iii) by the United States in this matter. He proposed that a panel be established with terms of reference reflecting that understanding, to be determined by the Council Chairman in consultation with interested parties and, according to GATT practice, with the agreement of the parties to the dispute, and that the Council Chairman be authorized to designate, in consultation with the parties concerned, the Panel's members. The Council so agreed (C/M/192, page 6).

1.4 At the meeting of the Council on 12 March 1986, the Chairman announced that the following terms of reference of the Panel had been agreed:

> "To examine, in the light of the relevant GATT provisions, of the understanding reached at the Council on 10 October 1985 that the Panel cannot examine or judge the validity of or motivation for the invocation of Article XXI:(b)(iii) by the United States, of the relevant provisions of the Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance (BISD 26S/211-218), and of the agreed Dispute Settlement Procedures contained in the 1982 Ministerial Declaration (BISD 29S/13-16), the measures taken by the United States on 7 May 1985 and their trade effects in order to establish to what extent benefits accruing to Nicaragua under the General Agreement have been nullified or impaired, and to make such findings as will assist the CONTRACTING PARTIES in further action in this matter" (C/M/196, page 7).

1.5 Following this announcement, the representative of the United States said the terms of reference had been drafted specifically for this case and would govern the Panel in this particular dispute. However, this should not imply that panels in other cases would not have to determine whether nullification or impairment existed. Only in this case did the United States not dispute the effects of a two-way trade embargo. Furthermore, the above terms of reference should not be interpreted to mean that any further action by the CONTRACTING PARTIES in this matter was necessary or appropriate. The representative of Nicaragua replied that, in his view, this Panel was not an exception; its functions would be those described in the 1979 Understanding (BISD 26S/211-218).

Consequently, the CONTRACTING PARTIES would have to take appropriate action on the Panel's report (C/M/196, page 8).

1.6 On 4 April 1986 the Chairman of the Council circulated a document (C/137) indicating that agreement had been reached on the following composition of the Panel:

Chairman: Mr. M. Huslid
Members: Mr. D. Salim
Mr. H. Villar.

1.7 The Panel met with the parties to the dispute on 9 May and 16 June 1986 and without the parties to the dispute on 9 July and 3 and 4 September 1986.

2. Documentation

2.1 The Panel had before it the following submissions by the two parties (in addition to the documents referred to in paragraphs 1.1-1.6 above):

- a memorandum dated 1 May 1986 with four annexes, presenting Nicaragua's position in respect of the dispute;

- a letter dated 29 April 1986 from the Geneva Office of the United States Trade Representative setting out the United States' position and transmitting the Executive Order of the President, and an annex with trade figures;

- a memorandum dated 2 June 1986 containing the rebuttal by Nicaragua of the United States' submission to the Panel;

- a letter dated 4 June 1986 from the Geneva Office of the United States Trade Representative, containing the rebuttal by the United States to the arguments presented by Nicaragua, with an annex containing the United States' Nicaragua Trade Control Regulations;

- a letter dated 30 June 1986 from the Permanent Representative of Nicaragua, transmitting the Esquipulas Declaration of 25 May 1986 and the text of the decision of the International Court of Justice of 10 May 1984 on the request for the indication of provisional measures in the case concerning Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America) and a communiqué dated 27 June 1986 concerning the judgement of the International Court of Justice in this case.

- a letter dated 3 July 1986 from the Geneva Office of the United States Trade Representation, refuting the relevance for the proceedings of the Panel of the material transmitted on 30 June 1986 by Nicaragua;

- a letter dated 4 July 1986 from the Permanent Representation of Nicaragua transmitting the full text of the judgement of the International Court of Justice.

3. Factual Aspects

3.1 On 1 May 1985 the President of the United States issued an Executive Order which reads:

> "...I, RONALD REAGAN, President of the United States of America, find that the policies and actions of the Government of Nicaragua constitute an unusual and extraordinary threat to the national security and foreign policy of the United States and hereby declare a national emergency to deal with that threat.
>
> I hereby prohibit all imports into the United States of goods and services of Nicaraguan origin; all exports from the United States of goods to or destined for Nicaragua, except those destined for the organized democratic resistance, and transactions relating thereto.
>
> I hereby prohibit Nicaraguan air carriers from engaging in air transportation to or from points in the United States, and transactions relating thereto.
>
> In addition, I hereby prohibit vessels of Nicaraguan registry from entering into United States ports, and transactions relating thereto.
>
> The Secretary of the Treasury is delegated and authorized to employ all powers granted to me by the International Emergency Economic Powers Act to carry out the purposes of this Order.
>
> The prohibition set forth in this Order shall be effective as of 12:01 a.m., Eastern Daylight Time, May 7, 1985 and shall be transmitted to the Congress and published in the Federal Register".

3.2 To permit an appraisal of the importance for Nicaragua of trade with the United States, there are reproduced hereunder tables indicating the share of the United States and other countries in Nicaragua's total trade in recent years (Table 1), the evolution of Nicaragua's trade with United States from 1977 to 1985 (Table 2), the main items exported to the United States in 1984 and their share in the total exports of these items (Table 3) and the main items imported from the United States in 1984 (Table 4). All figures are based on Nicaraguan statistics.

TABLE 1

Nicaragua: Trend of Structure of Trade in Goods
(Exports and Imports)
(per cent)

	1980	1984	1985
Central America	28.1	9.2	7.2
Latin America	13.5	12.8	9.2
United States	30.4	14.9	5.4
Western Europe	17.6	25.2	28.8
Eastern Europe	1.0	15.4	27.1
Japan	3.0	9.9	9.9
Canada	2.6	2.9	2.9
Cuba	-	4.0	4.3
Others	3.8	5.7	5.3
Total	100	100	100

TABLE 2

Nicaragua: Trade in Goods with the United States

(in US$'000)

Year	Total	Exports to the United States	Per cent of total	Total	Imports from the United States	Per cent of total
1977	636.805	144.887	23.8	781.927	219.501	28.8
1980	450.442	162.351	36.0	887.211	243.589	27.5
1981	508.265	116.774	23.0	999.440	262.886	26.3
1982	407.708	96.497	23.7	775.547	147.398	19.0
1983	431.295	77.741	18.0	806.915	156.680	19.4
1984	384.803	47.294	12.3	826.236	133.196	16.1
1985	298.519	20.102	6.7	892.291	67.105	7.5

TABLE 3

Nicaragua: Main Products Exported to the United States and Percentages of Total (1984)

(in US$'000)

	United States (1)	Total (2)	Per cent (1/2)
Sesame	433	5,904	7.3
Coffee	6,985	121,812	5.7
Sugar	4,107	20,904	19.6
Molasses	2,587	2,587	100.0
Bananas	11,878	11,888	99.9
Meat	6,609*	17,601	47.0**
Marine products	10,739	12,607	85.2
Tobacco and cigars	2,643	3,480	76.0
Others	1,303	188,020	0.7
Total	47,284	384,803	12.3

*If Puerto Rico is included the figure rises to 8,289.

**Including Puerto Rico.

TABLE 4

Nicaragua: Main Products Imported from the United States (1984)

(in US$'000)

Product	Value
Food	6,830
Beverages and tobacco	80
Crude materials, inedible	7,835.6
Mineral fuels and lubricants	3,825.2
Oils and fats	10,169.3
Chemicals	45,419.5
Machinery and transport equipment	37,429.5
Manufactures	22,129.3
Others	1.1
	133,719.5

3.3 According to calculations made by the GATT Secretariat almost all imports (more than 99 per cent) from Nicaragua into the United States are items for which the duties are bound under the General Agreement.

4. Main Arguments

4.1 Nicaragua argued that the prohibition of imports into the United States of goods of Nicaraguan origin and of exports from the United States to Nicaragua, imposed by the United States on 7 May 1985, (henceforth referred to as "the embargo") was inconsistent with the provisions of the General Agreement, impeded the achievement of its objectives and violated the commitments assumed by the United States under paragraph 7(iii) of the Ministerial Declaration of November 1982, and it requested the Panel to find that the embargo had nullified or impaired benefits accruing to Nicaragua under the General Agreement and to propose to the CONTRACTING PARTIES that they:

(a) recommend the immediate withdrawal of the embargo;

(b) grant to the contracting parties, in accordance with Article XXV and footnote 2 to paragraph 2 of the Enabling Clause (BISD 26S/203), a general waiver from their obligations under Article I which would permit them to give differential and more favourable treatment to products of Nicaraguan origin in order to restore the balance of rights under the General Agreement;

(c) recommend any additional measure of assistance or compensation the Panel may deem appropriate.

The United States suggested that it would not be advisable for the Panel to attempt a general interpretation as to when nullification or impairment existed or did not exist notwithstanding an invocation of Article XXI. Moreover, no recommendation could be proposed to remove the embargo since to do so would imply a judgement on the validity of the national security justification which Article XXI, by its terms, left to the exclusive judgement of the contracting party taking the action. In addition, the United States noted that nothing in the Panel's terms of reference, or Article XXIII, or GATT practice would give any other contracting party reason to expect any recommendation by the Panel directed to third parties not represented in this dispute.

4.2 The main arguments presented by the parties to the dispute in support of their requests are summarized below.

4.3 Nicaragua stated that the embargo had deprived Nicaragua of benefits under Articles I:1, II, V, XI:1, XIII, XXIV, XXXVI, XXXVII and XXXVIII. The embargo therefore constituted a prima facie nullification or impairment of benefits accruing to Nicaragua under the General Agreement.

4.4 The United States replied that it did not contest that certain trade-facilitating provisions of the General Agreement and the tariff concessions granted by both parties had no value for either party as a result of the embargo. However, the action was fully justified under Article XXI:(b)(iii) and hence did not constitute a violation of the General Agreement. The action therefore was not a prima facie case of nullification or impairment as defined in the Agreed Description of the Customary Practice of the GATT in the Field of Dispute Settlement (BISD 26S/216).

*4.5 Nicaragua stated that the United States could not properly rely on Article XXI:(b)(iii) in this case. This provision could be invoked only if two conditions were met: first, the measure adopted had to be necessary for the protection of essential security interest and, second, the measure had to be taken in time of war or other emergency in international relations. Neither of these conditions were fulfilled in this present case. Obviously, a small developing country such as Nicaragua could not constitute a threat to the security of the United States. The embargo was therefore not necessary to protect any essential security interest of that country. Nor was there any "emergency" in the sense of Article XXI. Nicaragua and the United States were not at war and maintained full diplomatic relations. If there was tension between the two countries, it was due entirely to actions by the United States in violation of international law. A country could not be allowed to base itself on the existence of an "emergency" which it had itself created. In that respect, Article XXI was analogous to the right of self-defence in international law. This provision could be invoked only by a party subjected to direct aggression or armed attack and not by the aggressor or by parties indirectly at risk. Nicaragua added that it must be borne in mind that GATT did not exist in a vacuum but was an integral part of the wider structure of international law, and that the General Agreement must not be interpreted in a way inconsistent with international law. The International Court of Justice had found that the embargo was one element of a whole series of economic and military actions taken against Nicaragua in violation of international law and that it was not necessary for the protection of any essential security interest of the United States, and it had declared that the United States must make reparation for the damage caused. The Security Council (Resolution 562) and the General Assembly (Resolution 40/188) of the United Nations had also condemned the embargo for infringing the principles of free trade and had explicitly demanded its rescinding. Consequently, Nicaragua held that the United States could not base itself on Article XXI in the particular case,

*The United States objected to the inclusion of paragraphs 4.5 and 4.7 in this report on the grounds that they fell outside the Panel's terms of reference. The Panel nevertheless felt that it should include these paragraphs because its terms of reference, while imposing limits on its examination and judgement, do not affect the parties' right to submit arguments and the Panel's duty to report on these arguments.

and that the trade measures under consideration constituted coercive measures applied for political reasons in contravention of paragraph 7(iii) of the Ministerial Declaration of November 1982, which obliged contracting parties to "abstain from taking restrictive trade measures, for reasons of a non-economic character, not consistent with the General Agreement."

4.6 The United States said that Article XXI applied to any action which the contracting party taking it considered necessary for the protection of its essential security interest. This provision, by its clear terms, left the validity of the security justification to the exclusive judgement of the contracting party taking the action. The United States could therefore not be found to act in violation of Article XXI. In any case, the Panel's terms of reference made it clear that it could examine neither the validity of, nor the motivation for, the United States' invocation of Article XXI:(b)(iii). The United States' compliance with its obligations under the General Agreement was therefore not an issue before the Panel. The United States added that it disagreed with Nicaragua's assessment of the security situation but it did not wish to be drawn into a debate on a matter that fell outside the competence of the GATT in general and the Panel in particular.

4.7 Nicaragua, while recognizing that it was not within the competence of the Panel to examine or judge the validity of or motivation for the invocation of Article XXI:(b)(iii), nevertheless felt that the Panel had sufficient legal material and other information before it to arrive at a conclusion on the consistency of the embargo with the provisions of the General Agreement.

4.8 Nicaragua stressed that, whether the invocation of Article XXI:(b)(iii) was justified or not, in either case benefits accruing to Nicaragua under the General Agreement had been seriously impaired or nullified as a result of the embargo. As recognized by the CONTRACTING PARTIES in the Agreed Description of the Customary Practice of the GATT in the Field of Dispute Settlement, recourse to Article XXIII was permitted if nullification or impairment resulted from measures taken by other contracting parties whether or not these conflicted with the provisions of the General Agreement (BISD 26S/216). It had also been recognized both by the drafters of the General Agreement (EPCT/A/SR.33) and by the CONTRACTING PARTIES (BISD 29S/29) that an invocation of Article XXI did not prevent recourse to Article XXIII. According to long-standing GATT practice, the benefits accruing to contracting parties under Article II could be nullified or impaired by measures consistent with the General Agreement that could not reasonably have been anticipated at the time when the tariff concessions were negotiated. Nicaragua had no reason to expect that an embargo would cut off all trade relations with the United States when the United States tariff concessions were negotiated, i.e. between 1949 and 1961. The benefits accruing to Nicaragua under Article II had therefore been nullified or impaired as a result of the embargo. Nicaragua further stated that

it was clear from the drafting history of Article XXIII that this provision was intended to protect not only the benefits under Article II but any benefit accruing to contracting parties under the General Agreement (EPCT/A/PV.12). The embargo had in fact nullified or impaired the benefits accruing to Nicaragua under all the trade-facilitating provisions of the General Agreement. On previous occasions panels had recommended the withdrawal of measures which, though not inconsistent with the General Agreement, had nullified or impaired benefits accruing to the contracting parties under it (BISD Vol. II/195 and 13S/48). Nicaragua asked the Panel to do so also in the present case.

4.9 The United States recognized that a measure not conflicting with obligations under the General Agreement could be found to cause nullification and impairment and that an invocation of Article XXI did not prevent recourse to the procedure of Article XXIII. However, nullification or impairment could not be presumed in cases in which Article XXI was invoked. This had to be made dependent on the facts and circumstances of the particular case, including the expectations that the contracting party bringing the complaint could reasonably have had when the party complained against negotiated its tariff concessions. However, the United States did not consider it meaningful for the Panel to propose in the present case a ruling on the question of whether nullification or impairment could be caused through measures under Article XXI. The earlier panels which had examined non-violation cases had recommended that the party complained against consider ways and means to remove the nullifying or impairing measure because they considered this recommendation to be appropriate in the circumstances. In the present case, such a recommendation would not be appropriate because the United States had made it clear from the outset that the embargo was motivated by security considerations and that any change in it was wholly dependent on such considerations. The ultimate power of the CONTRACTING PARTIES in cases in which a measure consistent with the General Agreement had nullified or impaired GATT benefits was to authorize the adversely affected contracting party to suspend the application of obligations to the contracting party that had taken the measure. Such an authorization would be of no consequence in the present case because the embargo had already cut off all trade relations between the United States and Nicaragua. The United States further said that normally the question of nullification or impairment required an examination of the "reasonable expectations" of the parties concerned. However, in such an examination the United States would argue that it had no expectation that the security situation giving rise to the embargo would arise, and the Panel would be drawn into a consideration of the political situation motivating the United States to invoke Article XXI. Such consideration was properly excluded by the terms of reference and to arbitrate such matters would be outside the competence of the Panel and of the CONTRACTING PARTIES.

4.10 Nicaragua said that it would be ready at any time to take part in further consultations with the United States with a view to finding an acceptable solution to the dispute. It seemed

unfortunately unlikely that the United States would accept a recommendation to lift the embargo. Nor did it seem probable that the United States would be ready to offer compensation for the trade damage caused by the embargo. A recommendation by the Panel that Nicaragua be authorized to withdraw its concessions in respect of the United States would indeed be a meaningless step because of the two-way embargo. For these reasons alternative solutions to re-establish Nicaragua's benefits under the General Agreement and to achieve the purpose of Article XXIII would need to be found. Nicaragua suggested that the Panel recommend that the CONTRACTING PARTIES grant a general waiver under Article XXV:5 which would permit the contracting parties which so desire to alleviate the effects of the embargo by giving, notwithstanding their obligations under Article I, differential and more favourable treatment to products of Nicaraguan origin. Nicaragua recalled in this context that footnote 2 to paragraph 2 of the Enabling Clause (BISD 26S/203) provided that "it would remain open for the CONTRACTING PARTIES to consider on an ad hoc basis under the GATT provisions for joint action any proposals for differential and more favourable treatment not falling within the scope of this paragraph". The differential treatment suggested could take many forms: for example, contracting parties which were members of regional trade arrangements could extend to Nicaragua the benefits accorded to the participants in such arrangements. Alternatively, contracting parties, acting jointly or individually, could reduce tariffs on products from Nicaragua to restore the balance that existed prior to the embargo.

4.11 Nicaragua provided the Panel with detailed estimates of the economic effects of the embargo which the proposed differential treatment was to compensate. Trade with the United States, which had been 30.4 per cent of Nicaragua's total trade in 1980, had declined to 14.9 per cent in 1984. This percentage had been reduced to 5.4 in 1985 as a result of the embargo. Total exports to the United States had declined from US$ 162 million in 1980 to US$ 47 million in 1984 and to US$ 20 million in 1985; and total imports from the United States, which stood at US$ 244 million in 1980, had declined to US$ 133 million in 1984 and US$ 67 million in 1985. In 1984 the United States was the principal market for Nicaragua's exports of molasses (100 per cent of total exports), bananas (99.9 per cent), marine products (85 per cent) and meat (47 per cent). Nicaragua estimated the direct damage caused by the need to purchase and sell in markets other than the United States to be US$ 93.3 million in 1985. This figure did not include the indirect effect of the embargo on the maintenance of the industrial structure of Nicaragua, its motor vehicle park and its main machinery and agricultural equipment. These indirect effects were not yet fully apparent but would no doubt be profound given the dependence of Nicaragua on the technology of the United States. Nicaragua added that the embargo had also serious adverse effects on the Central American Common Market consisting of Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica. The embargo had reduced Nicaragua's exports to the other members of the Central

American Common Market by 25 per cent in 1985. Of these exports 60 per cent consisted of industrial inputs and intermediate goods for the Central American industry. Consequently, the trade and supply of the Central American countries had been seriously affected and Nicaragua's possibilities of development in the framework of regional integration had been directly jeopardized.

4.12 The United States considered it improper for a panel to recommend any action to be taken by third contracting parties not parties to the dispute. Nothing in the Panel's terms of reference, or Article XXIII, or GATT practice would give any other contracting party reason to expect any recommendation by the Panel directed to third parties not represented in this dispute.

4.13 The United States added that, given that both parties agreed that the embargo cut off virtually all mutual trade, it was not necessary to demonstrate the embargo's trade impact through a detailed analysis of the trade statistics submitted by Nicaragua. To determine the indirect effects of the embargo on the Nicaraguan economy would be an impossible task because the effects of the embargo could not be segregated from the effects of other factors, not the least of which was the effect of Nicaraguan Government policies and management. The effects of the embargo on the other members of the Central American Common Market fell completely outside the purview of the Panel. The Panel should not consider effects on third countries which were not represented before the Panel and which had made no complaint.

4.14 Nicaragua replied that if the United States' views on the rôle of the Panel were accepted, the Panel would have no useful function to perform. It could not recommend the removal of the embargo, it could not recommend an authorization of suspension of obligations of Nicaragua in respect of the United States as this was meaningless in the circumstances, it could not recommend any action involving third countries and it could not consider any effects of the embargo other than direct trade effects on Nicaragua. The Panel could in other words only find something that was obvious: that trade had been embargoed. Nicaragua disagreed with the argument put forward by the United States that the only measure which the CONTRACTING PARTIES could take would be to authorize Nicaragua to withdraw its concessions. The objective of Article XXIII was not reprisal but the maintenance or restoration of the balance of interests by satisfactory adjustment. One of the basic benefits accruing under the General Agreement was consequently the right of contracting parties to such adjustment in any situation in which the balance of rights and obligations had been affected to their disadvantage. That adjustment, moreover, had to be satisfactory. To authorize Nicaragua to withdraw its concessions could in no way be considered a satisfactory adjustment, nor would it restore the balance of interests sought by Article XXIII. It would also have no practical meaning since the embargo affected both imports and exports. In Nicaragua's opinion, the CONTRACTING PARTIES were fully entitled to recommend any action that would result in mitigating the effects of the embargo,

provided that such action pursued the basic objectives of the General Agreement and was consistent with international law.

4.15 The United States agreed that the Panel was limited to a finding that trade had been embargoed and recalled that it had expressed that view consistently from the beginning of GATT discussions on this matter. The United States also recalled that it had cautioned from the outset that the GATT dispute settlement procedures were ill-suited to help resolve cases involving the invocation of Article XXI. The Council had decided to establish the Panel because that was Nicaragua's procedural right and the United States had agreed with the Council's decision for that reason. It had become apparent that the Panel could not help resolve the dispute by suggesting recommendations involving the parties to the dispute. This was no justification for the Panel to go beyond its competence and recommend actions by third contracting parties. The United States wished to emphasize that a solution to the dispute depended on the security situation and could only be found in a political context.

4.16 Nicaragua, in two written communications to the Panel (cf. paragraph 2.1 above), referred to the judgement of the International Court of Justice of 27 June 1986 in the case concerning Military and Para-military Activities in and against Nicaragua, which in the opinion of Nicaragua, fully endorsed the position of Nicaragua in respect of the embargo imposed by the United States. The United States stated that in its opinion the judgement by the International Court of Justice was irrelevant to the proceedings before the Panel and pertained to matters clearly outside the Panel's terms of reference.

5. Findings and Conclusions

5.1 The Panel first considered the question of whether any benefits accruing to Nicaragua under the General Agreement had been nullified or impaired as the result of a failure of the United States to carry out its obligations under the General Agreement (Article XXIII:1(a)). The Panel noted that, while both parties to the dispute agreed that the United States, by imposing the embargo, had acted contrary to certain trade-facilitating provisions of the General Agreement, they disagreed on the question of whether the non-observance of these provisions was justified by Article XXI(b)(iii), the relevant part of which reads:

> "Nothing in this Agreement shall be construed ... to prevent any contracting party from taking ... in time of war or other emergency in international relations .. any action which it considers necessary for the protection of its essential security interests."

5.2 The Panel further noted that, in the view of Nicaragua, this provision should be interpreted in the light of the basic principles of international law and in harmony with the decisions of the United Nations and of the International Court of Justice and

should therefore be regarded as merely providing contracting parties subjected to an aggression with a right to self-defence. The Panel also noted that, in the view of the United States, Article XXI applied to any action which the contracting party taking it considered necessary for the protection of its essential security interests and that the Panel, both by the terms of Article XXI and by its mandate, was precluded from examining the validity of the United States' invocation of Article XXI.

5.3 The Panel did not consider the question of whether the terms of Article XXI precluded it from examining the validity of the United States' invocation of that Article as this examination was precluded by its mandate. It recalled that its terms of reference put strict limits on its activities because they stipulated that the Panel could not examine or judge the validity of or the motivation for the invocation of Article XXI:(b)(iii) by the United States (cf. paragraph 1.4 above). The Panel concluded that, as it was not authorized to examine the justification for the United States' invocation of a general exception to the obligations under the General Agreement, it could find the United States neither to be complying with its obligations under the General Agreement nor to be failing to carry out its obligations under that Agreement.

5.4 Being precluded from examining the embargo in light of paragraph (a) of Article XXIII:1, the Panel proceeded to examine it in the light of paragraph (b) of Article XXIII:1. Consequently, it considered the question of whether benefits accruing to Nicaragua under the General Agreement had been nullified or impaired by the embargo whether or not it conflicted with the provisions of the General Agreement.

5.5 The Panel noted that the previous cases under paragraph (b) of Article XXIII:1 (BISD Vol. II/192-193 and BISD 1S/58-59) involved measures that had been found to be consistent with the General Agreement while in the present case it could not be determined whether or not the measure was consistent with the General Agreement. The Panel nevertheless considered the principles established in the previous cases to be applicable in the present case because a contracting party has to be treated as if it is observing the General Agreement until it is found to be acting inconsistently with it.

5.6 The Panel noted that the embargo had virtually eliminated all opportunities for trade between the two contracting parties and that it had consequently seriously upset the competitive relationship between the embargoed products and other directly competitive products. The Panel considered the question of whether the nullification or impairment of the trade opportunities of Nicaragua through the embargo constituted a nullification or impairment of benefits accruing to Nicaragua within the meaning of Article XXIII:1(b). The Panel noted that this question raised basic interpretative issues relating to the concept of non-violation nullification and impairment which had neither been addressed by the drafters of the GATT nor decided by the

CONTRACTING PARTIES. Against this background the Panel felt that it would only be appropriate for it to propose a ruling on these issues if such a ruling would enable the CONTRACTING PARTIES to draw practical conclusions from it in the case at hand.

5.7 The Panel then noted that Article XXIII:2 would give the CONTRACTING PARTIES essentially two options in the present case if the embargo were found to have nullified or impaired benefits accruing to Nicaragua under the General Agreement independent of whether or not it was justified under Article XXI. They could either (a) recommend that the United States withdraw the embargo (or, which would amount in the present case to the same, that the United States offer compensation) or (b) authorize Nicaragua to suspend the application of obligations under the General Agreement towards the United States.

5.8 As to the first of the above options the Panel noted the following: It is clear from the drafting history that in case of recommendations on measures not found to be inconsistent with the General Agreement, the contracting parties "are under no specific and contractual obligations to accept those recommendations" (EPCT/A/PV/5, p.16). The report of the Sixth Committee during the Havana Conference notes with respect to the power of the Executive Board to make recommendations to member States in any matter arising under Article 93:1(b) or (c) of the Havana Charter (which corresponds to Article XXIII:1(b) and (c) of the General Agreement): "It was agreed that sub-paragraph 2(e) of Article 94 does not empower the Executive Board or the Conference to require a Member to suspend or withdraw a measure not in conflict with the Charter". The 1950 Working Party on the Australian Subsidy on Ammonium Sulphate took the same view as to the powers of the CONTRACTING PARTIES (BISD Vol. II/195). In their 1982 Ministerial Declaration, the CONTRACTING PARTIES stated that the dispute settlement process could not "add to or diminish the rights and obligations provided in the General Agreement" (BISD 26S/16).

5.9 In the light of the above drafting history and decisions of the CONTRACTING PARTIES the Panel found that the United States, as long as the embargo was not found to be inconsistent with the General Agreement, was under no obligation to follow a recommendation by the CONTRACTING PARTIES to remove the embargo.

5.10 The Panel noted that in the past cases under paragraph (b) of Article XXIII:1, the CONTRACTING PARTIES had recommended that the contracting party complained against consider ways and means to restore the competitive relationship that existed when the tariff concession was made (BISD Vol. II/195 and BISD 1S/31). However, the Panel also noted that these recommendations had been made only because they were considered to offer the best prospect of a mutually agreed settlement of the dispute. It noted in particular the following statement in the report of the Working Party on the Australian Subsidy on Ammonium Sulphate:

> "The sole reason why the [withdrawal of a measure not found to be inconsistent with the General Agreement] is recommended is that, in this particular case, it happens that such action appears to afford the best prospect of an adjustment of the matter satisfactory to both parties" (BISD Vol. II/195).

The Panel noted that the United States had declared from the outset that it would not remove the embargo without a solution to the underlying political problem (paragraph 4.9 above). It also noted that Nicaragua had recognized that "it seemed unfortunately unlikely that the United States would accept a recommendation to lift the embargo" (paragraph 4.10 above). The Panel therefore considered that a decision of the CONTRACTING PARTIES under Article XXIII:2 recommending the withdrawal of the embargo would not seem to offer the best prospect of an adjustment of the matter satisfactory to both parties and that, in these circumstances, it would not appear to be appropriate for the CONTRACTING PARTIES to take such a decision unless they had found the embargo to be inconsistent with the General Agreement.

5.11 The Panel then turned to the second option available to the CONTRACTING PARTIES under Article XXIII:2 in the present case, namely a decision to authorize Nicaragua to suspend the application of obligations to the United States. The Panel noted that, under the embargo imposed by the United States, not only imports from Nicaragua into the United States were prohibited but also exports from the United States to Nicaragua. In these circumstances, a suspension of obligations by Nicaragua towards the United States could not alter the balance of advantages accruing to the two contracting parties under the General Agreement in Nicaragua's favour. The Panel noted that the United States had stated that an authorization permitting Nicaragua to suspend obligations towards the United States "would be of no consequence in the present case because the embargo had already cut off all trade relations between the United States and Nicaragua" (paragraph 4.9 above) and that Nicaragua had agreed that "a recommendation by the Panel that Nicaragua be authorized to withdraw its concessions in respect of the United States would indeed be a meaningless step because of the two-way embargo" (paragraph 4.10 above). The Panel therefore had to conclude that, even if it were found that the embargo nullified or impaired benefits accruing to Nicaragua independent of whether or not it was justified under Article XXI, the CONTRACTING PARTIES could, in the circumstances of the present case, take no decision under Article XXIII:2 that would re-establish the balance of advantages which had accrued to Nicaragua under the General Agreement prior to the embargo. In the light of the foregoing considerations the Panel decided not to propose a ruling in this case on the basic question of whether actions under Article XXI could nullify or impair GATT benefits of the adversely affected contracting party.

5.12 The Panel proceeded to consider the request by Nicaragua that the Panel recommend that the CONTRACTING PARTIES grant, in accordance with Article XXV:5 and footnote 2 to paragraph 2 of the

Enabling Clause (BISD 26S/203), a general waiver which would permit the contracting parties which so desire to compensate the effects of the embargo by giving, notwithstanding their obligations under Article I, differential and more favourable treatment to products of Nicaraguan origin.

5.13 The Panel examined whether it was appropriate for a panel established under Article XXIII to make recommendations on requests for waivers under Article XXV. It noted the following GATT practices and procedures on this question: Only once in the history of the GATT, in 1971, has a panel established under Article XXIII recommended a waiver pursuant to Article XXV. This waiver released the party complained against from an obligation which it had failed to observe (BISD 18S/33, 183-188). All other panels have proposed recommendations and rulings of the CONTRACTING PARTIES under Article XXIII:2 and not decisions under Article XXV. This practice is reflected in the 1979 Understanding on dispute settlement which states that "the function of panels is to assist the CONTRACTING PARTIES in discharging their responsibilities under Article XXIII:2" (BISD 26S/213). The procedures for waivers adopted by the CONTRACTING PARTIES in 1956 (BISD 5S/25) provide that requests for waivers are in principle to be submitted with a thirty-day notice, must be preceded by consultations between the applicant contracting party and other contracting parties having made representations and should be granted only if the CONTRACTING PARTIES are satisfied that the legitimate interests of all contracting parties are adequately safeguarded. This procedure ensures that the CONTRACTING PARTIES do not grant waivers without first considering the views of the contracting parties that would be directly affected by the waiver.

5.14 The Panel recognized that its mandate was to "... make such findings as will assist the CONTRACTING PARTIES in <u>further action</u> in this matter" (paragraph 1.4 above) while panels were normally asked "to assist the CONTRACTING PARTIES in making <u>recommendations or rulings, as provided for in Article XXIII:2</u>" (cf. for instance BISD 31S/68, 76 and 94 and BISD 32S/56) and that a recommendation on the waiver proposed by Nicaragua would therefore not be excluded by the Panel's terms of reference. However, the Panel concluded that it would be acting contrary to the GATT practices and procedures described in the preceding paragraph if it were to recommend a change in the obligations of third contracting parties that had no part in the Panel's proceedings and whose views it could therefore not consider. The Panel wishes to emphasize, however, that Nicaragua has the right to submit a proposal for a waiver directly to the CONTRACTING PARTIES and that the Panel's decision not to make a recommendation on the waiver is based on purely procedural grounds and should therefore in no way be interpreted as prejudging a decision by the CONTRACTING PARTIES on such a request. In this respect, the Panel also recalls that the consequences of the embargo on Nicaragua's trade and economy were severe and that, as noted in paragraph 5.6 above, the embargo had seriously upset the competitive relationship between the embargoed products and other directly competitive products.

5.15 The Panel wishes to note that in the course of the Panel proceedings Nicaragua had maintained that GATT could not operate in a vacuum and that the GATT provisions must be interpreted within the context of the general principles of international law taking into account inter alia the judgement by the International Court of Justice and United Nations resolutions. While not refuting such argumentation, the Panel nevertheless considered it to be outside its mandate to take up these questions because the Panel's task was to examine the case before it "in the light of the relevant GATT provisions", although they might be inadequate and incomplete for the purpose.

5.16 The Panel, noting that it had been given not only the mandate to prepare a decision of the CONTRACTING PARTIES under Article XXIII:2 but the wider task of assisting the CONTRACTING PARTIES in further action in this matter, examined the effects of the embargo on Nicaragua's economy and on the international trading system. The Panel noted that the embargo had brought the trade between two contracting parties to a standstill and that it had a severe impact on the economy of a less-developed contracting party. The Panel further noted that embargoes imposed for security reasons create uncertainty in trade relations and, as a consequence, reduce the willingness of governments to engage in open trade policies and of enterprises to make trade-related investments. The Panel therefore concluded that embargoes such as the one imposed by the United States, independent of whether or not they were justified under Article XXI, ran counter to basic aims of the GATT, namely to foster non-discriminatory and open trade policies, to further the development of the less-developed contracting parties and to reduce uncertainty in trade relations. The Panel recognized that the General Agreement protected each contracting party's essential security interests through Article XXI and that the General Agreement's purpose was therefore not to make contracting parties forego their essential security interests for the sake of these aims. However, the Panel considered that the GATT could not achieve its basic aims unless each contracting party, whenever it made use of its rights under Article XXI, carefully weighed its security needs against the need to maintain stable trade relations.

5.17 The above considerations and the conclusions to which the Panel had to arrive, given its limited terms of reference and taking into account the existing rules and procedures of the GATT, raise in the view of the Panel the following more general questions: If it were accepted that the interpretation of Article XXI was reserved entirely to the contracting party invoking it, how could the CONTRACTING PARTIES ensure that this general exception to all obligations under the General Agreement is not invoked excessively or for purposes other than those set out in this provision? If the CONTRACTING PARTIES give a panel the task of examining a case involving an Article XXI invocation without authorizing it to examine the justification of that invocation, do they limit the adversely affected contracting party's right to have

its complaint investigated in accordance with Article XXIII:2? Are the powers of the CONTRACTING PARTIES under Article XXIII:2 sufficient to provide redress to contracting parties subjected to a two-way embargo?

5.18 The Panel noted that in 1982 the CONTRACTING PARTIES took a "Decision Concerning Article XXI of the General Agreement" which refers to the possibility of a formal interpretation of Article XXI and to a further consideration by the Council of this matter (BISD 29S/23-24). The Panel recommends that the CONTRACTING PARTIES, in any further consideration of this matter in accordance with that Decision, take into account the questions raised by the Panel above.