

**THE WORLD TRADE ORGANIZATION AND REGIONAL TRADE
AGREEMENTS:**

An Analysis of the Relevant Rules of the WTO

by

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TABLE OF CONTENTS

Certificate.....	vi
Acknowledgements.....	vii
Abstract.....	viii
Chapter 1 Introduction.....	1
Chapter 2 Regionalism Versus Multilateralism.....	10
2.1 The Rise of Protectionism: 1914 – 1918 (the Interwar Years).....	10
2.2 The Resurrection of Multilateralism.....	15
2.3 The Demise of the ITO and birth of GATT.....	20
2.3.1 Competing Philosophies Between the Negotiating Parties.....	21
2.3.2 The International Environment.....	23
2.3.3 Institutional Framework	24
2.4 Origins of Article XXIV of the GATT	25
Chapter 3 Normative and Empirical Justifications for Regional Trade Agreements	31
3.1 Trade and Investment Creation and Diversion	32
3.1.1 Trade Creation and Trade Diversion	33
3.1.1.1 Limitations of Viner's theory.....	37
3.1.2 Investment Creation and Investment Diversion	40
3.2 Traditional (Static) Reasons	44
3.2.1 Efficiency Considerations	44
3.2.2 Trade Expansion	45
3.2.3 Means of Attracting Foreign Direct Investment	46
3.2.4 Political Considerations – Confidence Building	47
3.2.5 Easy Accession and Administration	48
3.3 Non-Traditional benefits of Regional Trade Agreements	49
3.3.1 Credibility of Domestic Reforms	50
3.3.2 Locking in Domestic Reforms	51
3.3.3 Increased Negotiating Leverage in the WTO and other fora....	52
Chapter 4 Relevant Multilateral Rules on Regional Trade Agreements....	56
4.1 Article XXIV of the GATT 1994	57

4.2	Examination of the Provisions of Articles XXIV:4-5 of the GATT 1994.....	59
4.2.1	The scope of Article XXIV:4 and its relationship with other provisions in Article XXIV of the GATT 1994.....	59
4.2.2	The scope of Article XXIV:5	67
4.2.2.1	The meaning of the phrase "as between the territories of contracting parties".....	69
4.2.2.2	The meaning of the phrase as "duties and other regulations of commerce".....	72
4.2.2.2.1	Quantitative Restrictions.....	72
4.2.2.2.2	Rules of Origin	79
4.2.2.2.3	Variable Levies	86
4.2.2.2.4	Customs User Fees	87
4.2.2.2.5	Duty Remission Schemes.....	88
4.2.2.3	Scope of the requirement relating to the obligation that duties and other regulations of commerce "shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations applicable in the constituent territories"	89
4.2.2.3.1	Meaning of "on the whole.....	91
4.2.2.3.2	Meaning of "general incidence of the duties and regulations of commerce".....	91
4.2.2.3.3	Meaning of "applicable in the constituent territories".....	98
4.2.2.4	Meaning of the terms "interim agreement", "reasonable length of time" and "plan and schedule".....	103
4.2.2.4.1	What constitutes an interim agreement	103
4.2.2.4.2	What information should a plan and schedule contain?.....	105
4.2.2.4.3	Meaning of the phrase "within a reasonable period of time".....	107

Chapter 5	Relevant Multilateral Rules on Regional Trade Agreements...	111
5.1	Scope of Article XXIV:6 of the GATT 1994.....	111
5.2	Scope of Article XXIV:7 of the GATT 1994.....	115
5.2.1	When should notification be made.....	116
5.2.2	What kind of recommendations could be made by the General Council.....	120
5.3	The scope of Article XXIV:8 of the GATT 1994.....	121
5.3.1	The Quantitative Approach.....	122
5.3.2	The Qualitative Approach.....	125
5.3.3	Other interpretative problems with Article XXIV:8.....	133
5.3.3.1	Unilateral trade references.....	133
5.3.3.2	The meaning of the phrase "duties and other restrictive regulations of commerce".....	136
5.3.3.2.1	The meaning of duties.....	136
5.3.3.2.2	The meaning of "other restrictive regulations of commerce.....	137
5.3.3.2.2.1	Regulation on preferred source.....	139
5.3.3.2.2.2	Export licensing schemes.....	139
5.3.3.2.2.3	Quantitative restrictions.....	140
5.3.3.3	The exceptions clause in Article XXIV:8.....	140
5.3.3.3.1	Is the list of articles exhaustive?.....	141
5.3.3.3.2	List of exceptions and the non-discrimination principle.....	143
5.3.3.4	The scope of Article XXIV:8 (a)(ii) – are parties to customs unions obliged to apply substantially the same duties and other regulations of commerce?.....	147
5.4	Agreements notified pursuant to the Enabling Clause.....	151
5.4.1	Requirements under the Enabling Clause.....	152
5.5	Agreements notified pursuant to Article XXV of the GATT 1994.....	156
5.6	Agreements notified pursuant to Article V of the GATS.....	158
5.6.1	Requirements under Article V of the GATS	159

Chapter 6	Evaluation of the Consistency of Regional Trade Agreements..	162
6.1	The examination process under the GATT.....	162
6.2	The examination process under the WTO.....	164
6.2.1	Institutional improvements.....	165
6.2.2	Operational improvements.....	165
6.2.2.1	Timely provision of information and WTO standard guidelines.....	166
6.2.2.2	Guidelines for the examination process.....	168
6.2.3	Critique of the guidelines.....	169
6.2.4	Panel of experts.....	171
6.3	Regional Trade Agreements and Dispute Settlement.....	173
6.3.1	Lack of Recommendations – implicit acceptance of agreement.....	175
6.3.2	Lack of Recommendations – rejection of the agreement.....	177
6.4	Review of GATT/WTO Jurisprudence.....	180
6.4.1	European Community – Tariff Treatment on imports of citrus products from certain countries in the Mediterranean region (L/5776).....	181
6.4.2	EEC – Member States' Import Regimes for Bananas, DS32/R.....	185
6.4.3	India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products, WT/DS90/R and WT/DS90/AB/R.....	189
6.4.4	Turkey – Restrictions on Imports of Textile and Clothing Products, WT/DS34/R and WT/DS34/AB/R.....	192
6.5	Should panels decide on the overall consistency of regional trade agreements with the provisions of Article XXIV.....	196
6.5.1	Concurrent jurisdiction.....	198
Chapter 7	Conclusion.....	200
7.1	Recommendations relating to the substantive rules of the WTO.....	204
7.1.1	Article XXIV:4.....	204
7.1.2	Article XXIV:5.....	205
7.1.3	Article XXIV:6.....	207

7.1.4	Article XXIV:7.....	208
7.1.5	Article XXIV:8.....	208
7.1.6	The examination process, regional trade agreements and settlement.....	209
7.1.7	Final thoughts.....	211
Annexes.....		212
-	Provisions of Article XXIV of the GATT 1994.....	213
-	Provisions of the Understanding on the Interpretation of Article XXIV of the GATT 1994.....	216
-	Regional Trade Agreements currently in force and those under negotiation.....	220
-	Decision of the General Council establishing the Committee on Regional Trade Agreements.....	237
-	Standard Format for information on Regional Trade Agreements.....	239
-	Procedures on reporting on Regional Trade Agreements.....	244
-	Guidelines on Procedures to improve and facilitate the examination process.....	246
Bibliography.....		251

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I certify that this thesis has not previously been submitted for a degree nor has it been submitted as part of requirements for a degree except as fully acknowledged within the text.

I also certify that the thesis has been written by me. Any help that I have received in my research work and the preparation of the thesis itself has been acknowledged. In addition, I certify that all information sources and literature used are indicated in the thesis.

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ABSTRACT

The proliferation of regional trade agreements in recent years raises the question as to whether they are building blocks or stumbling blocks for the multilateral trading system. Studies carried out by academics, the WTO and other reputable bodies have mostly indicated that they have in the past contributed to the efforts of the WTO in liberalising world trade by eliminating barriers to trade among the parties to the agreement and also by reducing barriers to the trade of third countries resulting in an increase not only of intra-trade between the parties, but also trade between the established regional trading bloc and the outside world. The WTO recognises the important contribution that could be made by regional trading arrangements to the multilateral trading system and has consistently stated that the two approaches are not mutually exclusive and could be complementary if regional trade agreements operate in full openness and comply with WTO rules.

Under the rules of the WTO, Members wishing to form free trade areas and customs unions have to comply with a number of requirements including liberalising substantially all their trade and ensuring that the general incidence of tariffs and regulations of commerce is not higher after the formation of the regional trading arrangement. The rules have been designed in such a way as to protect the interests of third countries. In fact, as stated in Article XXIV:4, "the purpose of a customs union or a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other...[Members] with such territories."

To ensure that regional trade arrangements comply with the relevant disciplines of the WTO, Members of the WTO are obliged to notify any trade agreement that they enter into for examination by the WTO. To date, over 100 agreements have been examined, but it is only in one case that there was a unanimous verdict. In the rest of the cases, opinions were sharply divided with parties to the examined agreements insisting on conformity, while third countries expressed a contrary opinion. The paralysis in the decision-making process could be attributed to the lack of clarity in the WTO rules and the consensus principle which enables the parties to the agreement to frustrate the examination process. If the WTO should be able to monitor effectively existing regional trade arrangements and the proposed ones which are very ambitious in

terms of the subject areas covered and the diverse membership, it is imperative for the rules of the WTO to be clarified and strengthened and also the decision-making process of the Committee on Regional Trade Agreements fundamentally reformed to enable it to make decisions.

Chapter 1

Introduction

“As the general incidence of all tariff and other trade barriers decline world-wide, assuming the trend of the last twenty years continue, the problem of preferential arrangements may fade in importance”¹

The main objectives of the General Agreement on Tariffs and Trade (GATT 1994), as set out in its preamble, are raising standards of living, ensuring full employment, developing full use of the world’s resources and expanding the production and exchange of goods. It aims to achieve these objectives by eliminating discrimination in international commerce and reducing barriers to trade.² The drafters of the General Agreement seemed to be of the view that discrimination among countries in international commerce could lead to the misallocation of the world’s limited resources and ignite unnecessary tensions among trading nations. They appeared firm in their belief that non-discrimination in international commerce could spur competition among nations resulting in efficiency in global production, enhanced quality and affordable prices for consumers. In other words, global welfare would be enhanced.

Article I of the GATT 1994 articulates the principle of non-discrimination in international trade. It obliges Members of the World Trade Organization (WTO) to grant unconditionally to each other any benefit, favour, privilege or immunity affecting customs duties, charges, rules and procedures that they give to products originating in or destined for any other country. This obligation, frequently referred to as the “most-favoured-nation” clause would, if strictly applied, prevent Members from forming regional trading blocs, as such blocs have the effect of discriminating against non-member countries, which could be WTO Members.³ Realising the difficulties that could ensue from a strict observance of this rule, derogations were allowed under very strict conditions.

¹Jackson (1969) p623. Thirty years have passed since this statement was made by Professor Jackson. Contrary to the expectations during that time, regionalism has grown in strength and could be said to be threatening the multilateral trading order established by the GATT/WTO.

²Pescatore et al (1991) pp10-11.

³See Frankel et al (1997) pp2-3. See further Vines (1995) p47.

The major exception to the most-favoured-nation clause is laid down in Article XXIV of the GATT 1994.⁴ According to this Article, Members of the WTO can form customs unions and free - trade areas with a view to abolishing or substantially reducing barriers against imports from one another, providing they do not “raise barriers to the trade of other...[Members] with such territories.”⁵ In other words, a regional trading agreement that impedes or frustrates the functioning of the multilateral trading system could be declared to be incompatible with the rules of GATT 1994.

During the Uruguay Round of trade negotiations, there was a surge in the number of regional trading agreements that were notified to the GATT, the predecessor of the WTO. In the first period of the negotiations (1986-1990), only five agreements were notified to the GATT Secretariat. This figure increased dramatically in the second and final phase of the negotiations (1990-1994); 28 agreements were notified in that period.⁶ The very fact that these agreements were notified at a time when the Uruguay Round, the most ambitious and comprehensive trade negotiations was taking place, is as curious as it is interesting.

Were countries losing faith in the multilateral trading system and placing their hopes and aspirations in bilateralism and regionalism? Did trade policy officials believe that bilateralism and regionalism offered a better route to global trade liberalisation; or could the proliferation of regional trade agreements during that time be attributed to the fear that the Uruguay Round negotiations were not going to succeed, as was predicted on numerous occasions after the failure to meet the original deadline? To put it differently, was bilateralism and regionalism seen then as an “insurance policy” in the event of the collapse of the talks, which were scheduled to be completed in 1990 but dragged on for another four years?

⁴Other exceptions to the MFN principle are the Enabling Clause which allows developed countries to grant preferences to developing countries, without having to extend them to other contracting parties of GATT/WTO and the “grandfather clause” which allows certain contracting parties to maintain preferences that were in force before the General Agreement. Another major exception to the MFN principle, which practically ceases to exist because of the “single undertaking” approach of the WTO, is the various non-tariff barrier codes which were negotiated during the Tokyo Round of Trade Talks. These codes operated on a “conditional” MFN basis as only signatories to them could enjoy the rights and obligations resulting from them. See Trebilcock and Howse (1995) pp26-27.

⁵Article XXIV: 4 of the General Agreement.

⁶WTO (1995) p1.

To some extent, the failure of the third WTO Ministerial Conference in Seattle in December 1999 has given rise to the same disillusionment with the multilateral trading system during the Uruguay Round negotiations.⁷ Under pressure from their corporations and other interest groups, countries which have traditionally been strong supporters of the multilateral trading system, such as Australia, New Zealand, Japan, and Singapore, are increasingly pursuing bilateral trade deals with some of their major trading partners, as their confidence in the ability of the multilateral trading system to safeguard and promote their trade interests has ebbed.⁸

The view has been expressed, however, that the proliferation of regional trading arrangements should not give cause for alarm, as the two approaches to global free-trade are not mutually exclusive. Regionalism, according to its most ardent supporters, has provided the impetus for the adoption of multilateral disciplines in areas like intellectual property and government procurement. It has acted as a laboratory for the testing of rules and principles with a view to their implementation at the international level. Support for the latter view has been expressed by some economists who argue that a division of the world into three trading blocs - Europe, the Americas, and East Asia - is the fastest road to multilateral free-trade.⁹

While it may be difficult to disparage this view given the protracted and difficult nature of multilateral trade negotiations, it would be equally hard to denigrate the claim that if the world were to be split into three trading blocs, certain regions and countries, notably those in Africa and the Middle-East, would be marginalised and make the task

⁷See speech ("Globalizing Regionalism: A New Role for MERCOSUR in the Multilateral Trading System", pp1-2) by the Director-General of the WTO, Mr. Mike Moore, delivered in Buenos Aires on 28 November 2000: "In the 1990s, it was widely assumed that building complementary regional and multilateral institutions was the only way to grapple with the complexities of a fast-changing international economy. But in the wake of Seattle – and our inability so far to launch a new global trade round – has the time come to question that easy assumption? Is there a risk that regionalism is becoming a stumbling-block, more than a building block, for the new WTO? Draining energy from multilateral negotiations? Fragmenting international trade? And creating a new international *dis*-order characterized by growing rivalries and marginalization and the possibility of hostile blocks?"

⁸Singapore has already concluded a free-trade agreement with New Zealand and is currently negotiating similar agreements with Japan, Australia and the United States. South Korea together with Japan and China are reportedly exploring the possibility of establishing a free-trade area, which could later on possibly link up with the Association of South East Asian Nations.

⁹Bergsten (2000) pp19-21. See further, de Melo and Panagariya (1992) p1.

of constructing an inclusive multilateral trading system difficult to attain. There is also no guarantee that the split of the world into three trading blocs would eventually lead to global free - trade. On the contrary, there is the risk that these three blocs may erect barriers to the trade of each other and jeopardise the gains that have been made since the creation of the GATT in the 1940's.¹⁰

With the successful conclusion of the Uruguay Round and talks under way for a new trade round at the WTO at which issues of concern to businesses and other relevant constituencies are expected to be addressed, one would have expected a staggering of the trend towards bilateralism and regionalism, considering the broad reach of multilateral disciplines and the globalisation of the world economy. As observed by the Director-General of the WTO:

"In the early 1980s, the United States, among others, took the regional road because they felt the old GATT system was faltering. That world has changed. Multilateral negotiations in the Uruguay Round succeeded, spectacularly so. There is a new World Trade Organization in Geneva empowered with a binding dispute settlement mechanism and a permanent institution to propel worldwide liberalization. Twelve countries have entered the WTO since 1995, bringing the total membership to 140. And many more should soon be joining – including of course, China, as well as Chinese Taipei and Lithuania. It is ironic that just as we are poised to create a universal trading system – a system which millions of people have worked to join – some governments at the regional and hemispheric level could unwittingly put that universality at some risk."¹¹

Nevertheless the number of initiatives that have been proposed or initiated clearly indicate that bilateralism and regionalism are here to stay. One of the most significant proposals made to date, although no concrete plans have been drawn up, is the establishment of a Pacific Free - Trade Area (PAFTA) which would link the Americas and East Asia. It is estimated that "such a bloc would be twice the size of the

¹⁰In a speech to APEC Trade Ministers in Christchurch, New Zealand on 15 July 1996, the then Director-General of the WTO, Mr Renato Ruggiero, observed that "we risk fragmentation of the global economy into two, three or four preferential regional blocs, each one with its own rules and procedures, confronting each other at border. This is not the way in which trade can best contribute to building a more integrated, more balanced, and ultimately a more secure world".

¹¹*Supra* note 7 at p5.

European Union's economy".¹² When it was first proposed in 1992, it drew a sharp reaction from Australia, which wanted Japan, its largest trading partner, to be included in the arrangement.

Another initiative of equal importance is the Asia - Pacific Economic Cooperation (APEC). Currently member countries of APEC account for 46 per cent of the world's merchandise trade, and about 50 per cent of the world's total annual output. Under the terms of their informal agreement, the developed members are expected to abolish all tariffs and non - tariff barriers to trade by the year 2010, while the developing country members are expected to accomplish that objective by the year 2020. Another important initiative is that of the Trans - Atlantic Free - Trade Area, which would link the European Union with the North American Free - Trade Area. The idea was reportedly given short shrift when it was originally proposed by Prime Minister John Chretien of Canada.¹³ However, it is now being reported that governments and businesses on both sides of the Atlantic are studying it with great interest.¹⁴ Business leaders have already been meeting under the auspices of the Conference of the Transatlantic Business Dialogue (TADB). The prospect of the NAFTA countries and member states of the European Union coming together to form a free - trade area drew a sharp response from the former Director-General of the WTO, Mr. Renato Ruggiero. He was of the view that such an agreement could undermine the multilateral trading system and possibly erode the gains that have been made since the creation of the system in 1947.

The recent proliferation of regional trade arrangements, especially the move to have continent and inter-continent-wide free - trade agreements¹⁵ such as the proposed

¹²See "Joining Hands Across the Pacific" in the 21 January 2001 edition of the *Financial Times*. The article discusses the policy perspectives of the new United States Trade Representative, Mr. Robert Zoellick.

¹³According to the then Canadian Minister for International Trade when he and Prime Minister Chrétien first spoke about building an economic bridge between Europe and North America "the idea was treated as almost whimsical--at best a distraction from more pressing interests in Asia and Latin America, at worst a romantic echo of a bygone era": MacLaren (1995).

¹⁴The British Prime Minister, Mr. Tony Blair, recently called for the establishment of a free - trade area between the European Union and NAFTA: see report by Agence France-Presse entitled "EU official plays down idea of EU-NAFTA trade pact" (AFP); 5 March 2001.

¹⁵Already there are plans for the establishment of a free - trade area in the Americas, in Africa and in the APEC region. The European Union looks likely to expand to include countries in Eastern and Central Europe. It has concluded a free - trade agreement with South Africa,

Free - Trade Area for the Americas (FTAA), the proposed Free - Trade Agreement between the European Union and the Southern Cone Common Market (MERCOSUR) and the European Union and Mexico, has led some Members of the WTO and international economists to revisit the issue of the complementarity of such arrangements with the multilateral trading system. They are of the view that regionalism, if not strictly monitored or controlled, could cause the fragmentation of the multilateral trading system. They make this prediction notwithstanding the indications in empirical studies carried out by reputable bodies such as the WTO, the Organisation for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF) and the World Bank, that regionalism has on the whole been very supportive of the multilateral trading system. They argue that the lack of tension between multilateralism and regionalism to date owes much to political restraint and the simplicity of some of the agreements that were notified to the GATT.

They point to the increasingly complex agreements that are being entered into by countries which contain provisions ranging from competition policy to investment, subjects which are not yet regulated at the international level. The ground covered by some of these agreements lends credence to the theory that they have the potential to upset the delicate balance which has been established between regionalism and multilateralism. The adoption of different rules on subjects not regulated at the international level by the various regional bodies may complicate efforts to reach agreement at the international level, as each group may insist on the superiority of its rules and refuse to give them up during negotiations. The challenge currently confronting policy makers is to find ways to ensure that regionalism continues to support the multilateral trading system in breaking down barriers to international trade.

The objective of this dissertation is to establish that the relevant rules of the WTO (Article XXIV of the GATT 1994) are fundamentally weak and incapable of guaranteeing that regional trade agreements will continue to remain supportive of the multilateral trading system. The rules are so ambivalent that they have failed to provide the necessary guidance to WTO Members wishing to form regional trading arrangements, and also to Working Parties established to determine the consistency of

Mexico and some Mediterranean countries. It is also on track to negotiating a free - trade agreement with countries belonging to MERCOSUR.

these arrangements with the multilateral trade rules. The Working Parties have examined over 150 regional trade agreements, but conclusive results were given in only one case. Thus, the legal status of all examined regional trade agreements remains unclear. The fact that an agreement may be in force does not mean that it has been approved by the WTO as being consistent with its rules.

Given the proliferation of regional trade agreements and the real risk that they could undermine the multilateral trading system, this dissertation makes suggestions for strengthening the relevant rules of the WTO and improving the examination process so that the Committee on Regional Trade Agreements, which is now charged with the responsibility of examining the consistency of agreements with the relevant multilateral trade rules, could reach definitive conclusions.

This dissertation draws heavily on published GATT/WTO documents, as very little has been written on the subject from a legal perspective. Most of the literature on the subject has been written by economists who have been primarily concerned with the issue of trade diversion and trade creation, and the impact of regional trade agreements on the multilateral trading system. By contrast, considerable debate on the relevant rules of the WTO has taken place in the Working Parties established to examine the consistency of regional trade rules with the provisions of Article XXIV of the GATT 1994 and in the recently established Committee on Regional Trade Agreements.

The dissertation is divided into seven sections. The second section provides a brief overview of events during the interwar period, and discusses the rise of protectionism among the major trading nations. It also traces attempts by policymakers in the United States and the United Kingdom to fashion a multilateral trade order based on certain key principles, especially the non-discrimination principle, and traces the history behind Article XXIV.

The third section examines the normative and empirical reasons for the formation of regional trading arrangements. The reasons examined include the desire of countries to achieve peace and security to enable them to promote economic growth and sustainable development, the belief that a regional economic grouping could assist them to achieve economies of scale and increase the negotiating leverage of the constituent

member countries during multilateral trade negotiations, as well as their chances for attracting foreign direct investment.

The fourth and fifth sections examine the substantive and procedural requirements of Article XXIV and the interpretative difficulties that have been encountered over the years, and the attempts by the Understanding on the Interpretation of Article XXIV to resolve some of these difficulties. A number of suggestions are made to tighten the rules in light of the overall objective of ensuring that regional trade agreements complement the multilateral trading system as embodied in the WTO. The fourth section examines the provisions of Article XXIV:4-5 of the GATT 1994, while the fifth section examines the provisions of Article XXIV:6-8 and provisions of the Enabling Clause, which is an alternative legal basis for the formation of regional trade agreements by developing countries.

The sixth section considers the examination process and analyses the consequences of the failure by WTO Members to arrive at definitive conclusions regarding the consistency of an agreement with the provisions of Article XXIV. It examines whether unlike the Working Parties, which were established to examine the consistency of agreements with the provisions of Article XXIV, the Committee on Regional Trade Agreements would be in a position to reach conclusions on the compatibility of agreements with the multilateral rules. A number of suggestions are made for strengthening the examination process and making it easier for the Committee to reach conclusions.

This section also reviews the relevant panel decisions on whether the dispute settlement provisions of the WTO can be invoked to challenge the consistency of an agreement with the multilateral trade rules. It analyses whether panels should be allowed to rule on the consistency of an agreement with the provisions of Article XXIV, especially considering that, out of more than 100 Working Parties that have been established, only one was able to come to a unanimous decision. The relevant provisions of the Understanding are examined, in that context, to determine whether they authorise Members to challenge the consistency of an agreement with the provisions of Article XXIV, or whether they allow Members to invoke the dispute settlement provisions to challenge the operation of a regional trading arrangement.

The seventh concluding section, summarises the salient points made in this thesis.

Chapter 2

Regionalism Versus Multilateralism

One of the most vexing issues confronting international economists, trade officials and policymakers today is whether the spread of regional trade arrangements is compatible with the multilateral trade order established in 1948 under the auspices of GATT and now the WTO. This issue is hardly novel, as it has been debated since the beginning of this century, especially during and after the Second World War. At the heart of the matter is whether the two approaches are mutually exclusive or whether they are complementary in the sense that they reinforce each other and work towards achieving the same objective i.e. the reduction/elimination of barriers to world trade.

To put the issue in its proper perspective, it is necessary to look back to the interwar years and determine the effects of the economic and trade policies which were pursued by the then major trading nations. Two main periods could be isolated for the purposes of this study, namely the period between 1914 and 1928 and the period from 1929 until the outbreak of the war ten years later.

2.1 *The Rise of Protectionism: 1914 – 1939 (the Interwar Years)*

Notwithstanding the havoc that was wrought on the world economy by the First World War, the major trading nations did not completely abandon their laissez-faire attitude towards international trade.¹⁶ Whereas their priority immediately after the war turned to the rebuilding of their economies, they did not aggressively adopt protectionist policies to shield their industries from foreign competition. Average tariffs on imports in the major trading nations were quite moderate compared to the rates which were later imposed in the late 1920s, and their trade policies mostly had an outward-oriented posture. In fact, the early 1920s have been variously described in the literature as the period of globalism. The major trading nations did not exhibit any special preference for bilateralism or regionalism over multilateralism. Contrary to expectations at that time,

¹⁶The use of discriminatory tariffs was a feature of the commercial policy of France, Germany, Spain and other countries even before the first World War. See Brown (1950) p29.

world trade grew by a reasonably healthy margin confirming the confidence that countries had in multilateralism. As noted by Patricia Clavin:

“During the 1920s, when the world’s leading economies still espoused the principles of free - trade, believed to have brought unprecedented growth to the world economy in the nineteenth century, the volume of world trade was on a gentle but upward trend. Taking 1929 as the base year of 100, world trade had grown from 94.3 in 1925 - over 6 per cent in four years - despite the generally fragile state of the world economy.”¹⁷

The fragile state of the world economy in the aftermath of the war created constituencies in the major trading nations which urged their governments to jettison free - trade principles and adopt protectionist policies to shield domestic industries from foreign competition. Some governments later capitulated to this demand and imposed extraordinarily high tariffs and a number of non-tariff barriers including quantitative restrictions with the view of making imports uncompetitive in their domestic markets. This nationalistic sentiment was not confined to Europe alone, but also had roots in North America and Japan. The United States, for example, whose economy had been the least affected among the then major industrial powers erected high tariff walls so as to nurture and consolidate its domestic industries, which were later to dominate the world. Germany, France and Britain also succumbed to this wave of nationalism and imposed discriminatory tariffs and other trade-restrictive measures in the late twenties and early thirties. The flagrant breaches of the unwritten multilateral rules governing international trade, economic and monetary relations between states meant a significant shift in the trade and economic policies of countries which had from time immemorial professed their faith in multilateralism.

In order to counteract the disastrous effects of these “beggar thy neighbour policies”, which as pointed out took the form of high tariffs and numerous non-tariff barriers, most countries “sought refuge in bilateralism and regional trading arrangements and retaliated against increased protectionism by devaluing their currencies and raising their tariffs”.¹⁸ The de facto delineation of the world economy into competing trade blocs was to prove disastrous for the world economy: world trade

¹⁷Clavin (1996) p32. See further Curzon (1966) p22.

¹⁸Geiger (1996) p56. See further Arndt (1944).

and economic growth stagnated and even plummeted to levels never previously recorded:

“By 1932, three years after the Great Depression had taken hold, the trade index had fallen to 39.1 per cent, a fall of 60 per cent. By 1934 it had fallen to 34 and although world trade rose to 40.5 per cent in 1938, it was still 60 per cent lower than it had been in 1929, this despite the fact that most countries had surpassed the GDP levels attained in 1929. The armaments of trade protection were widespread and varied, encompassing such measures as sanitary regulations, duties levied against ‘abnormal (dumped) imports, general flat rate tariffs and quota systems. The history of the Great Depression seemed to prove that no nation was immune from the highly contagious protectionist fever which flourished in the severely depressed economic environment. By 1931, Germany, France, Czechoslovakia, Spain, Hungary, Austria and the United States taxed protected imports by over 40 per cent, with some protective taxes rising as high as 68.5 per cent in the case of Spain. No example is more convincing than that of Britain whose move to protectionism in 1932 marked the end of a commitment to free - trade begun in 1846 which, to many, had not merely coincided with but sponsored the unprecedented expansion and dominance of Britain in the world economy of the nineteenth century”.¹⁹

Economic historians have for some time debated strenuously the reasons why protectionism triumphed over liberalism during the late 1920s and early 1930s. The loss of confidence of countries in multilateralism, and the resort to bilateralism and regionalism to further trade, financial and economic interests has not been attributed to one particular cause. According to some accounts, the principal reason why the major trading nations became inward-looking and implemented protectionist policies was the failure by the United States “to recognise and fulfil its responsibilities as a hegemon in the world economy”. The absence of a hegemon to dictate, monitor and enforce the unwritten rules of international economic relations, it has been argued, assured countries that they could pursue their own narrow interests and ignore the collective interests of the international community.²⁰

This reasoning has been challenged by some commentators who argue, and in my view persuasively, that it would not be appropriate to attribute the rise of protectionism in the late 1920s and early 1930s to the policies implemented by the United States or its failure to exercise the tremendous influence it had after the First

¹⁹Clavin (1996) p32

²⁰Clavin (1996) p33

World War to get other nations to maintain liberal policies.²¹ The fact that the United States was probably the only economic superpower at that time did not mean it had responsibility to regulate international economic relations. Even if the United States was willing to assume that role, it would have only succeeded if other countries such as Britain, Germany and France were willing to coordinate and cooperate with it. It is known that these countries failed to cooperate “to combat the depression because their analyses of the causes of the depression [which were different], coupled with the priority of national politics, left little common ground between them”.²²

The immediate goals of most European countries straight after the war did not coincide with the interests of the United States. Whereas the war bankrupted several European nations, the economic position of the United States was considerably strengthened by it. Restoring internal balance (full employment, low inflation and steady economic growth) was uppermost in the minds of European policymakers, who were prepared to pursue any policy options which would facilitate the achievement of their objectives including increasing trade and generally forging closer economic links with neighbouring countries. As rightly pointed out by Clavin:

“The triumph of regionalism over globalism in the interwar period owes far more to the failures of multilateral cooperation in an increasingly complex political and ever-changing economic world, than to the failure of the United States to exert leadership in the world economy. *The regionalism which gripped Europe, in particular, after 1930 was not triggered primarily as a retaliatory response to the protectionist measures adopted by others, but was largely conditioned by internal political and economic elements which, for a variety of reasons, were able to exert a particularly strong influence over international trade.*”²³ (italics added)

The disastrous effects of these “beggar thy neighbour policies” soon became apparent to policymakers, who realised that these policies were not only punishing their trading partners, but also their own economies which lost much of the dynamism displayed in the preceding years. Keeping out imports meant that their industries could no longer have access to cheaper raw materials, inputs and spare parts and technology.

²¹Geiger (1996) p57. See further Kindleberger (1987).

²²Clavin (1996) p33.

Consequently, a number of industries in the major trading nations operated under very uncompetitive conditions. Resources which could have been put to good use in other sectors were diverted into the production of goods which could have been imported cheaply from elsewhere. Instead of achieving economic growth, the economies of most countries contracted during this period.

This led policymakers and economists to search for solutions to this emerging problem which threatened the prosperity, peace and security of the world. The view was advanced by some economists that the only viable solution was to reject protectionism and the short-sighted economic and monetary policies designed and implemented by governments to achieve internal balance. Reformist economists and policymakers, partially influenced by the writings of Maynard Keynes, who had reasoned in his seminal book, *The General Theory of Employment, Interest and Money*, that external balance (balance of payments in equilibrium, stable exchange rate) could be achieved only as an extension of internal balance²⁴, argued for a complete overhaul of the world economy. They argued forcefully that the fortunes of countries were intertwined and that it would be illusory for any country to think that it could pursue expansionary economic policies in isolation and achieve healthy economic growth and prosperity. A spirit of good neighbourliness was needed to replace the mistrust and deep suspicions that countries harboured as a result of the war. By and large, the writings of these prominent economists and policymakers influenced the governments of the major trading nations, particularly the United States and the United Kingdom who during the war started negotiations on a blueprint for the global economy.

2.2 *The Resurrection of Multilateralism*

Once it became clear to governments that they could no longer pursue expansionary economic policies in isolation and expect robust economic growth, security and prosperity, they became open to the idea of the creation of a multilateral framework to regulate international economic relations among countries. The United States, still smarting from the accusation that it shied away from its responsibilities by not recognising and fulfilling its role as a hegemon in the world economy, was

²³Clavin (1996) p35. See further Simmons (1944).

²⁴Keynes (1949).

determined to capture the high-ground and lead in the effort to reconstruct the world economy, after its disruption by a patchwork of bilateral and regional trade and commercial agreements. The United States had become the most dominant economic power and had grown in self-confidence.²⁵ It did not have to look to the United Kingdom for direction. It realised, however, that without the active support of the United Kingdom and other European powers particularly France (the Allies), it would be difficult to formulate proposals which would be acceptable to the rest of the world.

During preliminary discussions between American and British officials about the shape of the post - war economy, it soon became apparent that reaching an agreement on liberalisation of world trade was going to be immensely difficult. Whereas both the British and the Americans agreed on the need to liberalise world trade, their suggested approaches to achieving that objective revealed a wide gulf between them. Beneath the clash between their foreign economic policies was the desire of each to maintain some forms of protectionism to satisfy some very powerful domestic constituencies. In any case, the focus of their initial discussions was on the creation of a stable international monetary and financial system. Negotiators from the two countries reasoned that a stable international monetary and financial system was needed to restore currency convertibility and normalise financial relations between countries, without which it would be extremely difficult to engage in international trade.²⁶

After difficult negotiations, the two sides were able to produce a document which formed the basis for the negotiations. The document, known as the White and Keynes Plan, was released in the spring of 1943. It included plans for the free working of a multilateral payments mechanism and the abolition of commercial controls that impeded international adjustments. The following year the Bretton Woods Conference was convened to draft charters for the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank). In the course of the negotiations, the participants underlined the need to establish a multilateral trade regime. They were of the view that an effective multilateral regime which would

²⁵An interdepartmental memorandum issued by the State Department's Division of Commercial Policy allegedly stated that "the only nation capable of taking the initiative in promoting a world-wide movement toward the relaxation of trade barriers is the United States". See Gardner (1956) p102.

guarantee stability, economic growth and prosperity could not be created by planning on the financial side alone; it also needed to be based on equivalent measures in the field of commercial policy. To that end, they recommended that efforts should be made to ensure a reduction of “obstacles to international trade and in other ways promote mutually advantageous international commercial relations”.²⁷

As indicated above, the negotiations for the establishment of a multilateral trade regime proved more difficult due to the legacy of interwar protectionism. The Great Depression had severely distorted normal trade patterns and restoring these was the priority of most European powers including the United Kingdom and France. The United Kingdom, in particular, was determined to maintain the trade links it had with its colonies. Any new multilateral trade regime which ignored this aspect of British foreign economic policy was unacceptable. The Americans, on the other hand, were determined to persuade Britain to end its imperial preference system, as they thought it was distorting world trade and giving an unfair advantage to the British. A level-playing field on which all trading nations could compete based on their comparative advantages was what was needed to rejuvenate world trade and increase the prosperity of the world.²⁸ Nevertheless given the commonality of interests and traditional links between the two countries, they agreed to launch exploratory talks on post World War commercial policy, as they had done with international monetary and financial policy. After protracted negotiations the two countries produced the Atlantic Charter in August 1941 which outlined their plans and objectives for the future. Among other things, it was stated that it was their “desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labour standards, economic development and social security”. That “they will endeavour, with

²⁶Curzon (1966) p29.

²⁷Jackson (1969) p40.

²⁸It has been suggested that the British imperial preference system was less distortive of world trade than the economic policies of Germany and Japan: "After the Nazi ascent to power Germany sought to dominate economic relations with its neighbours through a web of bilateral trading agreements. Except in the Balkans, this strategy did not succeed in establishing an autarchic economic space under exclusive German control...Other forms of economic regionalism, including the Soviet-style state trading and the Japanese Co-Prosperity Zone, similarly exploited smaller countries in the vicinity. As a general trend, countries resorted to preferential trade agreements. However, the economic regionalism of the British Commonwealth and Empire only marginally altered trade flows among member countries...Arguably, the British imperial preference system proved far less disruptive to the

due respect for their existing obligations, to further the enjoyment by all states, great or small, victor or vanquished, of access, on equal terms, to the trade in the raw materials of the world which are needed for economic prosperity".²⁹

As previously noted, the Americans were interested in creating a level playing field for all countries. They were against all forms of preferences, as they thought these had the potential of distorting international trade and creating unnecessary tensions between countries. In a foreign economic policy speech, the then Under Secretary of State, Mr Sumner Wells underlined this point:

"Nations have more often than not undertaken economic discriminations and raised up trade barriers with complete disregard for the damaging effects on the trade and livelihood of other peoples, and, ironically enough, with similar disregard for the harmful resultant effects upon their own export trade...The resultant misery, bewilderment, and resentment, together with other equally pernicious contributing causes, paved the way for the rise of those very dictatorships which have plunged almost the entire world into war".³⁰

Whereas Britain and other European countries appreciated the American point of view on an intellectual level, they entertained the fears that acceptance of it would mean giving the Americans *carte blanche* to dominate the world economy. The British, in particular, had calculated that given the competitiveness of American industry, they could not compete with the Americans on their home turf, even if they significantly reduced their tariffs. The only way they could redress the imbalance, to a certain extent, was to maintain the imperial preferences system. The American Administration knew that they could only convince Congress to reduce tariffs on imports when they had obtained a similar gesture from foreign governments. Their experience was based on the comments that were made by the legislators when passing and extending the validity of the Reciprocal Trade Agreements.

world economy than the aggressive foreign economic policies of Germany and Japan": see Geiger (1996) pp59-60, citing Hirschman (1980).

²⁹Jackson (1969) p40.

³⁰*Ibid* at p38. The then Director of the Office of Economic Affairs of the Department of State made a similar observation: "We've seen that when a country gets starved out economically, its people are all too ready to follow the first dictator who may rise up and promise them all jobs. Trade conflicts breeds non-cooperation, suspicion, bitterness. Nations which are economic enemies are not likely to remain political friends for long".

To ensure that Britain compromised on its imperial preferences system, the Americans promised financial aid and a reduction of their tariffs. The British were hesitant, as they thought the American offer would be insufficient to offset the losses that they would incur if they were to give up the preferences system. With the passage of time a number of events, including the controversial Savannah Conference,³¹ proved that notwithstanding American romanticism with free and non-discriminatory practices in international monetary, financial and commercial relations, there was a limit to how far they were prepared to go to achieve this “overarching” objective. American enthusiasm was subject to limits defined by domestic political considerations and international aspirations.³²

The British and other European powers came to accept that, and realised that if progress was to be made in the negotiations they had to make compromises; they could not expect the Americans to abandon all their initial negotiating positions. The extent to which they had to go to make compromises was to be determined in the following years. After an understanding was reached between American and British negotiators, the American government released in 1945 a draft proposal for the establishment of an “International Trade Organization (ITO)”. Among other things, the proposal isolated four issues which had to be dealt with comprehensively, if efforts to establish a non-discriminatory international trading regime were to succeed.³³

In December 1945, the United States government invited a number of countries to Washington with the view of entering into negotiations for a multilateral trade

³¹The Savannah Conference was convened with the view of setting up the World Bank and the IMF, elect their first directors and formulate policy. Whereas others nations, particularly Britain, pressed for a liberal interpretation of the “scarce currency” clause in the Articles of Agreement of IMF, the Americans insisted on a restrictive interpretation of the clause, as they did not want the IMF to “become a sieve for the outpouring of American dollars”. The policy difference arose because the other nations wanted countries with trade surpluses to make their currency freely available to the IMF, which in turn would make the currency available to countries experiencing huge balance of payments deficits. The proposal of the other nations would also have allowed countries experiencing chronic balance of payments difficulties to discriminate against the exports of creditor nations. In the end, the American position was somewhat prevailed. Resort to the “scarce currency” provision could only be resorted to in exceptional circumstances and only with American consent: see generally Meade (1948) pp1-18.

³²Geiger (1996) pp62-63.

³³These are (a) restrictions imposed by government; (b) restrictions imposed by private companies and cartels; (c) fear of disorder in the markets for certain primary commodities; and (d) irregularity or the fear of irregularity in production and employment: see Jackson (1969) pp40-41.

agreement. The United States hoped that the newly established United Nations Economic and Social Council (ECOSOC) would be the focal point for all efforts to establish a non-discriminatory international trading system. Accordingly in February 1946, it tabled a motion at the first session of ECOSOC for the convening of a "United Nations Conference on Trade and Employment" to start work on the drafting of a charter for an International Trade Organization, and also to pursue multilateral negotiations for reductions in world-wide tariffs. Following the adoption of this resolution by the ECOSOC, a Preparatory Committee was established to discharge this mandate. Before its first meeting in October 1946, the United States government issued for its consideration a "Suggested Charter for an International Trade Organization", which was based on proposals jointly drafted by American and British negotiators following their bilateral meetings.³⁴

The draft charter formed the basis for the negotiations between the countries that were invited to Washington, and was amended at successive conferences from 1946 to 1948 in London, New York, Geneva and Havana to accommodate the views of the participating countries. The final version was agreed on at Havana in March 1948, and became known from that time as the "Havana Charter". The Charter was later presented to governments for ratification, but it failed to receive the endorsement of the American administration, which sensing the mood in Congress, decided not even to seek Congressional approval for it. Given America's unique position in the world economy at that time, it became clear that the Charter could not survive and that plans for the establishment of the ITO had to be shelved.

2.3 *The Demise of the ITO and the birth of GATT*

The failure by the American Administration to receive congressional support for the Havana Charter was in some respects odd, as the Charter reflected mostly the views of American policymakers. As previously noted, the Charter was based on proposals drawn up by American and British negotiators following many hours of bilateral negotiations. One conclusion which could probably be drawn from the chronology of

³⁴The results of the bilateral negotiations between the United States and the United Kingdom were incorporated in a document entitled "Proposals for Expansion of World Trade and Employment".

events is that there was not close cooperation between the Administration and Congress, otherwise the former would have insisted on the incorporation of provisions which would have allowed the passage of the Charter in Congress. The defeat of the Charter was a defeat of American ideals and aspirations.

Throughout the negotiations for the establishment of the ITO, the Americans inculcated upon their negotiating parties the virtues of a non-discriminatory international trading regime, and the resulting need to abolish all non-tariff barriers and reduce progressively tariffs on imports. To make sure that governments would not renege on their undertakings, the Americans insisted on a legally binding agreement, under which aggrieved countries could seek redress. This legalistic approach reflected American confidence in regulation, and its determination to resist abusing its new status as the world's leading economic power. A rules-based system in their minds would help restore confidence, certainty and predictability in the multilateral trading system. As noted by Professor Dam:

“Simply stated, the U.S. position was that, in general, non-tariff barriers should be abolished forthwith and that all tariffs should be reduced through international negotiations. The U.S. view of the means best calculated to achieve these substantive goals was equally important. Oversimplified only slightly, it was that all non-tariff barriers should be flatly prohibited within the framework of a comprehensive code governing world trade. This codification would limit severely the right of individual governments to interfere with the free flow of private trade. Transgression of the code would be an unlawful act. The role of the international body that would be the institutional expression of the code would be to interpret and, if need be, to enforce the code; its role would thus be not unlike that of a court determining whether crimes have occurred...The code would lay down the law, and the members would be law-abiding.”³⁵ (italics added)

It has been suggested that the American blueprint for the world trading system was too ambitious and failed to take into account the realities at home and abroad. Professor Dam has given three reasons why the Havana Charter became so unpopular leading to its rejection in the United States Congress, and the consequent demise of the plans to establish an International Trade Organisation to oversee world trade and lay down the rules governing international trading relations between countries.

2.3.1 *Competing Philosophies Between the Negotiating Parties*

As has been stated, it was the ambition of the Americans to reconstruct after the end of the war a non-discriminatory multilateral trading system which would guarantee almost the same level of treatment to all countries. That negotiating strategy meant that it would be incompatible for countries to maintain preferential regimes which discriminated against countries which were not parties to a regional trade agreement.

The Europeans, particularly the British and the French, were adamant to abolish all restrictions not for reasons purely connected with “conventional protectionism”, but for what they perceived as overriding national interests. Most countries were reluctant to devalue their currencies and adopt flexible exchange rates because of concerns relating to inflation. The need to create employment for millions of people who were put out of work during the war made some countries reluctant to remove wartime controls and other barriers to trade. They wanted to rebuild and strengthen their ruined domestic industries before opening up to foreign competition.

The prevailing view in several European countries was that unbridled free - trade could hamper national economic recovery and prolong the economic crises experienced during the war. Countries experiencing balance-of-payments difficulties wanted to have the flexibility to impose quantitative restrictions and other restrictions to safeguard their foreign exchange reserves, so also did countries in the early stages of development. Countries which believed in a strong role for government in international trade did not want to completely cede their “obligations” under any agreement. They wanted the flexibility to assist industries which had an export potential by being able to grant them subsidies, and shield them away from competition by use of tariffs and quantitative restrictions.

With these divergent views, it became clear that the United States had to make concessions on its proposals, if it were to win the support of the then major countries such as France and the United Kingdom:

³⁵Dam (1970) pp12-13

“The code that the United States sought could, however, only be put into effect by common agreement. Consequently, the U.S. draft of this code was shot full of holes, first at home by the need to permit continuation of certain U.S. protectionist policies, then abroad by the British insistence on continuing the imperial preference arrangement (which involved discrimination by the Commonwealth countries in favor of one another) and on retaining the right to use quantitative restrictions to protect the shaky pound sterling, and finally at the drafting conferences by countries that differed profoundly from the United States in their view of the role of the state in international trade. *The result was a grotesquely complicated document that included a multitude of detailed compromises and that all too often saw a free - trade principle followed immediately by an exception authorizing trade restrictions.*”³⁶ (emphasis added).

The failure of the American government to gain the support of other countries for its original proposals turned American public sentiment against the Havana Charter. Many observers questioned the benefits of the proposed Charter to American economic interests. If anything, it was third countries who stood to gain from an agreement which would commit the United States to reducing tariffs, restricting the use of subsidies and generally granting third countries more liberal access to the American market. It is reported that an article in the *Fortune* magazine entitled “How the U.S. Lost the ITO Conferences” captured the prevailing mood in the United States.³⁷

2.3.2 *The International Environment*

It has been suggested that U.S. trade diplomacy in the aftermath of the war failed because of the insistence of its policymakers on a more legalistic model for conducting international economic and financial relations. During the economic crises of the late 1920s and early 1930s, American policymakers came to believe that regulation was necessary if there was to be economic recovery. The emergence of the American economy from recession and its subsequent ascendancy to the most powerful economy in the 1940s was credited in part to regulation by the then government. If regulation had worked at the domestic level, then it should work at the international level. The code-of-laws approach favoured by the United States was judged to be ill-suited for the international environment considering the very different backgrounds, values and economic interests of the various countries participating in the conferences. To quote Professor Dam again:

³⁶Dam (1970) p14.

³⁷*ibid.*

“[The] code-of-laws approach was ill-adapted to the nature of the international economy and to the international financial system. The code was to operate in an uncontrolled environment in which the quantity, content, and direction of world trade was constantly changing as a result of natural economic forces...Prewar trading patterns had been destroyed, and postwar patterns had not been definitely established...The international financial system was not designed to permit major changes to occur smoothly without direct controls on trade. Monetary reserves were concentrated in only a few countries. The remaining countries had no reserves to fall back upon when imports threatened to exceed exports. The international community was committed by tradition and by the Articles of Agreement of the International Monetary Fund to a financial regime under which adjustments in exchange rates was permitted, but only as a last resort. Small and frequent changes in exchange rates, which were precisely what was needed to deal with most payments imbalances, were considered incompatible with the rules of the financial system.”³⁸

Given the overriding goal of most countries to reconstruct their war-ravaged economies and put millions of people back to work, there was the reluctance to accede to any agreement which would limit their options. A legally binding comprehensive trade agreement together with the Articles of Agreement of the IMF would have constrained their ability to adopt policies which would spur economic growth and promote employment, even if only in the short or medium term. Had U.S. policy makers opted for a less rigid approach, it could have found overwhelming support for most of its proposals.

2.3.3 *Institutional Framework*

Another reason given for the failure of U.S. trade diplomacy was its policymakers' insistence on setting up an institution and endowing it with well-defined functions leaving it with no significant room to manoeuvre. The role the United States wanted the ITO to perform was to some extent mechanical. It wanted it to be the guardian of the Havana Charter, which meant it would have had the responsibility of applying and enforcing the rules embodied in the Charter. It could not have acted as a forum for finding appropriate solutions to disputes that might have arisen between the parties. The legalistic approach preferred by the United States was thought not to be apposite given the very different backgrounds and economic interests of the signatories to the Charter. It has been argued that for the ITO to fulfil the aspirations of the major

trading nations, it had to be flexible in its interpretation of the rules that had been agreed upon. A strict interpretation of the rules would have frustrated the attempts by many countries to rejuvenate their economies and create employment:

“What was needed was not an enforcement agency, but rather, in view of the differences that divided countries and of the economic and financial environment of international trade, an institutional framework within which countries might examine the particular circumstances of specific trade problems, thereby, if possible, identifying their common interest and working out mutually acceptable solutions. Since the different policies pursued by different countries reflected competing values, it was important to create procedures for clarifying the common interests of the various trading countries and for establishing the impact of specific commercial policies.”³⁹

It is no coincidence that the GATT which became the principal institution for regulating world trade after the war eschewed legal solutions to problems that arose from the application of the provisions of the General Agreement. There was the tendency to search for amicable solutions to problems that arose between contracting parties to the Agreement. Its employment policy was even biased against lawyers; the first lawyer is reported to have been recruited in 1981. It is interesting to note that the recruitment of more lawyers by the GATT/WTO has resulted in the institution becoming more legal-oriented. Increasingly the WTO Agreement is being seen as a contract between countries whose terms have to be respected judiciously by its signatories.⁴⁰

2.4 *Origins of Article XXIV of the General Agreement*

The genesis of the present Article XXIV of the General Agreement is Article 38 of the first draft Charter of the ITO, which was drafted at the meeting of the Preparatory Committee of the United Nations Conference on Trade and Employment (“UNCTE”) in London.⁴¹ It contained provisions dealing with the territorial application of chapter V of the Charter (“General Commercial Policy”), customs unions and frontier traffic. The pertinent part of the Article (paragraph 2) i.e. the part dealing with customs

³⁸ *Ibid* at p15.

³⁹ *ibid* at p20.

⁴⁰ See generally Petersmann (1997).

⁴¹ The discussions on Article 38 were based on Article 33 of a draft Charter submitted to the Preparatory Conference for deliberations by the United States.

unions, provided that the commercial policy rules should not be construed to prevent advantages accorded by any member to adjacent countries in order to facilitate frontier traffic, “or the formation of a union for customs purposes” of any customs territory of any member and any other customs territory on the condition that the duties and other regulations of commerce imposed by any such union in respect of trade with other members should “not on the whole be higher or more stringent than the average level of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union”.⁴²

The London draft contained a provision which required any member proposing to enter into a customs union to consult with the ITO, and furnish it with all relevant information about the proposed union so as to enable the Organisation to make appropriate recommendations to the members. It also contained a new provision which would allow in exceptional circumstances a deviation from the MFN principle to permit the creation of new preferential arrangements, provided two-thirds of the members of the ITO would support such an arrangement.⁴³ At the meeting of the Drafting Committee in New York in 1947, no substantial changes were made to the London Charter by the Preparatory Committee.

At the second session of the Committee in Geneva later in the year, a number of changes were made to the London Charter. Firstly, the first paragraph of what had now become Article 42, on the territorial application of the Commercial Policy Chapter, was redrafted. Secondly, language was added to the effect that contracting parties could adopt an interim agreement for the formation of a customs union, provided the agreement had annexed to it a definitive plan and schedule for the attainment of the union within a reasonable period of time. The proviso to paragraph 2(b) was altered to read that the duties and other regulations of commerce imposed by, *or any margins of preference maintained by*, any customs union or interim agreement in respect of trade

⁴²See note MTN.GNG/NG7/W/13 prepared by the GATT Secretariat on Article XXIV of the General Agreement, 11 August 1987. See further WTO (1994) Vol2, pp739-740. The term “a union of customs territories prior to the formation of such union” was defined in Article 38 as “the substitution of a single customs territory for two or more customs territories, so that all tariffs and other restrictive regulations of commerce as between the territories of the union are substantially eliminated and substantially the same tariffs and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union”.

⁴³ MTN.GNG/NG7/W/13.

with members of the ITO should not on the whole be higher or more stringent than the average level of the duties and regulations of commerce or *margins of preference* applicable in the constituent territories prior to the formation of a union or the adoption of an interim agreement. Procedural rules relating to interim agreements were also written into the Geneva draft. The provision relating to the new preferential arrangements in exceptional circumstances was deleted and covered under Article 15 of the Economic Development Chapter entitled “Preferential Arrangements for Economic Development”.

Article 42 of the Geneva Draft Charter was included as Article XXIV of the General Agreement on Tariffs and Trade, which was concluded in October 1947. The new Article XXIV, however, contained two new provisions which were not in the Geneva draft.⁴⁴ A substantial revision of Article 42 of the Draft Charter occurred at the plenary of “UNCTE” at Havana in 1947/48. The three subjects which had been covered by one Article (territorial application, customs unions and frontier traffic) were now dealt with in separate articles.⁴⁵ The relevant Article for our purposes, Article 44, contained very novel provisions as to significantly change the content of the provisions of the Geneva draft on customs unions. Firstly, Article 44 of the Havana Charter for the first time made provision for the establishment of free - trade areas, which was quite surprising given the well known objections to such arrangements by the United States. It has often been assumed that Article 44 was expanded at the insistence of France, Syria and Lebanon who were interested in forming a trading arrangement which would give them some autonomy in their dealings with third countries. It has been suggested, however, that the prime mover for the redrafting of Article 44 was the United States, which for ideological reasons did not want it to be known that it was in favour of free - trade agreements on a limited scale:

⁴⁴Paragraph 5 of the original Article XXIV permitted India and Pakistan to enter into special arrangements with respect to their mutual trade. Paragraph 6 obliged contracting parties to ensure the observance of the provisions of the General Agreement by regional and local authorities within their respective territories.

⁴⁵The new Article 42 which dealt with territorial application was an amended version of the first paragraph of Article 42 of the Geneva Draft Charter. Article 43 of the Havana Charter dealt with frontier traffic, which was dealt with under paragraph 42:2 (b) of the Geneva Draft Charter. Customs Unions were dealt with under Article 44 of the Havana Charter.

"[T]he real origin of the concept of free - trade areas in Article XXIV lies in North America. Concurrent with the Havana discussions, Canada and the United States were actively engaged in secret discussions aimed at the possibility of negotiating the removal of all tariffs and other customs barriers on trade between them, while retaining room for both to maintain independent policies vis-à-vis third countries. US officials were prepared to consider such an agreement, but they were concerned that it would seriously undermine the fragile consensus that had led to the GATT. They sought, therefore, additional rules in article XXIV tailor-made for the possibility of a Canada-US free - trade area but capable of preventing easy abuse of this new departure from the MFN principle by others. Given, however, the doctrinaire opposition of the US delegation to preferences, particularly British imperial preferences, US delegates prevailed upon France and its allies in the Mediterranean to carry the ball on the issue."⁴⁶

Secondly, the first paragraph of Article 44 contained a completely new text which sought to reinforce the idea that regional trading arrangements should have as their objective the creation of trade between its constituent territories, and not to discriminate against third countries:

"Members recognise the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognise that the purpose of a customs union or free - trade area should be to facilitate trade between the parties and not to raise barriers to the trade of other Member countries with such parties."

Thirdly, the criterion relating to the effects of the duties and other regulations of commerce of a customs union or interim agreement necessary for the formation of a customs union was redrafted to read that the duties and regulations imposed should not on the whole be higher *or more restrictive than the general incidence* of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement. A new paragraph 5 dealt with the issue of the ramifications of customs unions and free - trade areas on preferences. It was provided that negotiations take place between parties to such arrangements and Members affected by the elimination or adjustment in preferences.

Fourthly, the procedural rules relating to interim agreements for the establishment of free - trade areas and customs unions were strengthened. The definition

of a customs union was amended and a definition of a free - trade area added. A new provision was also inserted which provided that the ITO could, by a two-thirds majority of its Members present and voting, approve proposals which did not fully comply with the terms of Article 44 of the Charter, provided the ultimate result of such proposals would be the establishment of a free - trade area or a customs union.

As the General Agreement on Tariffs and Trade was expected to be subsumed under the ITO, a special protocol was signed to incorporate the above elements of the Havana Charter. Article 42 of the Havana Charter became paragraphs 1 and 2 of Article XXIV, while Article 43 became paragraph 3 of the amended Article XXIV. Paragraphs 4 and 5 of the amended Article XXIV corresponded closely with paragraphs 1 and 2 of Article 44 of the Havana Charter. Paragraphs 7-10 of the new Article XXIV were based on paragraphs 3-6 of the Charter. A new paragraph, which was not introduced by the Havana Charter but included in the revamped Article XXIV, dealt with the issue of compensatory tariff reductions in cases where the formation a customs union would entail the breaking of tariff-bindings contrary to Article II of the General Agreement.

From 1948 only two minor changes have been made to the text of Article XXIV.⁴⁷ The word “parties” in the second sentence of paragraph 4 was replaced by the phrase “constituent territories”, and the phrase “provided for” after the word “schedule” in the first sentence of paragraph 7 by the word “included”. An Understanding on the Interpretation of Article XXIV of GATT 1994 was added to the General Agreement by Members following the conclusion of the Uruguay Round.

⁴⁶Hart (1995).

⁴⁷It should be pointed out that the Understanding on the Interpretation of Article XXIV modifies, albeit, some of the provisions of Article XXIV. See discussion in sections four and five of this dissertation.

Chapter 3

Normative and Empirical Justifications for Regional Trade Agreements

The creation of regional trade arrangements is not something new. Throughout history, patterns of trade have been influenced by geographical proximity of countries. Countries which share borders are more likely to have extensive trading relations, even if there is no formal agreement between them to cooperate on trade issues. The pace of regional integration in the last half of the 20th century was driven as much by geopolitical considerations as economic considerations. For the nearly 140 Members of the World Trade Organisation, almost all of whom are parties to at least one regional trade agreement, with the notable exception of Japan, Korea and Hong Kong, China,⁴⁸ the reasons for the participation in such arrangements run the gamut of insecurity of continued access to the markets of (big and economically powerful) neighbouring countries and the desire to take advantage of economies of scale to improving political ties with trading partners.

The professed faith of the Members of the WTO in the primacy of the multilateral trading system seems to have been seriously undermined by the increasing participation of Members in regional trading arrangements whose underlying principle basically runs counter to the MFN principle.⁴⁹ As noted by Gary Sampson, “while the pillar of the World Trade Organization (WTO) with respect to trade in goods, services, and intellectual property is non-discrimination, the cornerstone of regional trading arrangements is discrimination”.⁵⁰ Members of the WTO are constantly downgrading their expectations, as regional trade agreements continue to proliferate, with the consequence of the loss of competitiveness, in some cases, in the new regional markets.

⁴⁸It is probably not accurate to say that these three countries do not belong to any regional trading group. Their participation in APEC, which aims at the establishment of a free - trade area among all the constituent parties by the year 2020, seems to suggest that they also are pursuing simultaneously regional initiatives to further their trade interests.

⁴⁹In the Singapore Ministerial Declaration, adopted on 13 December 1996, Ministers noted that “We reaffirm the primacy of the multilateral trading system, which includes a framework for the development of regional trade agreements, and we renew our commitment to ensure that regional trade agreements are complementary to it and consistent with its rules”: see WT/MIN(96)/DEC, p2.

⁵⁰Sampson (1994) p1.

With the end of the cold war and the significant achievements made during the Uruguay Round in reducing tariff and non-tariff barriers to trade and investment, and extension of the principles underpinning the multilateral trading system to services and intellectual property, the search for reasons why WTO Members are rushing or queuing up to join regional trading arrangements has become difficult, especially considering that the scope of a number of agreements does not go further than the multilateral disciplines embodied in the WTO Agreement. Among the principal achievements of the Round are the reduction of average tariff rates on manufactured goods in industrial countries from 6.3 per cent to 3.8 per cent and the reduction of tariff escalation and tariff peaks by a significant margin. Further, about 43 per cent of the imports of developed countries from MFN origins will be duty-free.⁵¹ Stronger and comprehensive disciplines have been enacted for agriculture and textiles, and the dispute settlement system of the GATT has been strengthened restoring confidence of Members in the system. The Uruguay Round for the first time enacted binding multilateral disciplines for services and intellectual property.⁵² The motivation for the formation of regional trading arrangements in recent years could be conveniently grouped under two headings, namely traditional and non-traditional reasons. Before examining these reasons which are usually given by Members of the WTO as justification for the conclusion of regional trade agreements, it is in order to examine briefly the key concepts of trade creation and trade diversion.

3.1 Trade and Investment Creation and Diversion

One issue which has sharply divided international trade economists is the welfare implications of regional trading arrangements.⁵³ Whereas economists such as Fred Bergsten and Lawrence Summers tend to generally view them positively as welfare-enhancing instruments⁵⁴, Jagdish Bhagwati and Arvind Panagariya tend to see them as no more than discriminatory trading entities which exist to serve primarily the narrow interests of the participating countries and undermine efforts at multilateral trade

⁵¹WTO (1995) p2.

⁵²WTO (2000c).

⁵³Winters (1999) pp5-49.

⁵⁴Bergsten (2000) pp19-21.

liberalization.⁵⁵ The whole debate about regionalism has centred around the question as to whether they create or divert trade from non-participating countries.⁵⁶ Ever since Jacob Viner's seminal analysis on this issue, trade economists have spent undue time analysing it, but have not been able to arrive at a unanimous conclusion. Notwithstanding its limitations⁵⁷, Viner's theory remains the most influential benchmark against which most trade economists and diplomats measure regional trade agreements to determine whether or not they are welfare-enhancing, although it should be noted that WTO rules do not specifically refer to the concepts of trade creation and trade diversion.⁵⁸

3.1.1 *Trade Creation and Trade Diversion*

According to Viner, trade creation takes place when, as a result of the formation of a regional trade agreement, a participating member country increases its imports of a product from another participating country or starts importing a product which it formerly produced at home under uncompetitive conditions. Trade diversion, on the contrary, takes place when a participating member country replaces its imports of a product from a non-participating country with identical or similar products produced in a participating member country. The following example demonstrates Jacob's Viner's theory: Let us suppose that countries A and B enter into a preferential trade agreement. Both produce air conditioners of the same design and quality but at different costs; the cost of manufacturing in A is \$500, while the cost in B is \$450. Let us further assume that before the formation of the free - trade area, A imposed a tariff of 20 per cent on all

⁵⁵See 18 October 1997 edition of the *Economist*: "[t]he biggest problem...which increasingly bothers scholars of international trade is the "systemic" effect of proliferating [preferential trade agreements] (PTAs). A few PTAs are just bad; in larger numbers, their bad effects multiply. Seen through Mr. Bergsten's rose-tinted glasses, the trade effects of a multitude of PTAs can be gauged simply by adding up, as it were, the series of partial liberalisations. A world with lots of PTAs, he supposes, has lower trade barriers and hence is moving towards global free - trade. This is false economics: you cannot simply add these tariff reductions together. In principle, a preferential reduction of barriers can increase total protection in the world, in an economically meaningful sense, because of trade diversion".

⁵⁶The key concepts of trade creation and trade diversion were introduced by Jacob Viner who, in his book, *The Customs Union Issue*, (1950) refuted the dominant view prevailing then that customs unions facilitated a more efficient allocation of factors of production. See further Van Mourik (1977).

⁵⁷It has been argued that Viner's theory focuses primarily on the supply of goods. In so doing, he "neglected the changes in the amounts demanded due to the elimination of tariffs on the partner country's products.": Van Mourik, *ibid* at p22. Michaely (1976) also argues that Viner underestimated the potential gains from customs unions by not taking into account the increase in consumer surplus.

imports originating in country B. Thus, air-conditioners manufactured in country B could only be sold in country A for \$540. The effect of the tariff would leave consumers with no choice but to purchase air-conditioners produced at home, as they will be cheaper than those imported from country B by \$40. Should country A abolish the 20 per cent tariff it imposes on all exports from country B, the situation would change, as the effect of this new policy would be to encourage consumers in country A to substitute locally produced air-conditioners with those produced in country B, as they would make a saving of \$50 on each air-conditioner. According to Viner's analysis, if this situation were to occur, it would generate efficiency gains for the constituent territories and possibly benefit the world at large. Global welfare would be enhanced to the extent that goods in the preferential trade area would be produced in the constituent territory where manufacturing and related costs are the lowest. Non-participating countries could benefit from this situation, as demand for intermediate and final goods may increase.

On Viner's analysis, trade diversion would occur if as a result of the formation of a preferential trading arrangement, a constituent territory were to replace imports from an efficient non-participating country with imports from a participating country. This is likely to occur as the reduction or abolition of tariffs on products originating in a partner country makes them less expensive than those produced by an efficient non-participating country. The following example demonstrates this point. Let us assume that there are three countries A, B and C. All of them manufacture refrigerators. Among the three C is the most efficient producer, as its manufacturing costs per refrigerator are \$1000. The corresponding figures for A and B are \$1200 and \$1250, respectively. To protect their domestic producers, the governments of A and B impose a tariff of 30 and 35 per cent, respectively on all imports of refrigerators from all sources. Thus, C can sell its refrigerators in A and B for \$1300 and \$1350, respectively. For the sake of argument, it is assumed that C's market share in both countries is around 30 per cent.

Let us further assume that A and B conclude a regional trade agreement under which they agree to eliminate tariffs on all products originating in each other's territory, but decide to maintain their individual tariffs on products originating in third countries.

⁵⁸Laird (1999) p1179.

The effect of this agreement as far as refrigerators are concerned is that A would make significant inroads in B, as it would be able to sell its refrigerators there for \$1200. By contrast, C, which is not a party to the regional trade agreement, would still have to pay 35 per cent tariff on its refrigerators. Thus, the price for its refrigerators in B will remain unchanged. Consumers who used to patronise C's products will switch to those manufactured by A, as they will be cheaper by \$100.

A number of conclusions can be drawn from this scenario. First, the regional trade agreement between A and B is trade diverting and will reduce global welfare. Consumers in B are denied the opportunity of purchasing refrigerators from the most efficient producer, C, at \$1000. The regional trade agreement would have created trade if the parties' external tariffs were very low or if, upon the implementation of their agreement, they had reduced their tariffs to a reasonable level to allow C to compete. To put it differently, very low tariffs can spur competition within the regional trade agreement, as non-participating countries which are very efficient can still maintain their market shares or even increase them. Higher tariffs, as demonstrated above, will on the other hand shut out producers of non-participating countries resulting in some losses to the participating countries of the regional trade agreement. Notwithstanding this possibility, it has been suggested that the favourable terms of trade that may be obtained by members of the regional trade agreement may induce other countries to apply for membership:

"Although the net effect on the demand of each RTA country is ambiguous (since own demand has fallen but member demand has increased), if goods are sufficiently strong substitutes the demand for third party goods will decrease. Thus, in order to clear markets the price of third-party goods will have to fall which (as long as no member country's price decreased by too much) will create a positive terms of trade effect for the member countries...This potential "beggar thy neighbour" effect of RTAs can make the latter an attractive proposition for potential members despite any negative trade diversion effects on member countries."⁵⁹

Another conclusion which could be drawn and has been recently highlighted by a number of international trade economists including Panagariya, Spilimbergo and Stein is that the regional trade agreement would generate a redistributive effect which would

⁵⁹Fernández (1997) p5.

hurt B, as it would lose tariff revenue it collected on exports from C. The gains would accrue to A which would take advantage of the situation and increase its exports to B. Provided it has the capacity, it would capture all or a significant portion of the market share of C in B, which was estimated to be around 30 per cent. As noted by Panagariya, “the larger the quantity of trade [between the parties], the larger the redistribution and the greater the loss”.⁶⁰

It is conceivable that B would gain similar benefits in respect of products in which it has a comparative advantage. The gains would be smaller, if A imposes very low tariffs on those products. This is because if third countries are very competitive in those particular sectors, they can still hold on to their market shares. In effect, high-tariff countries are likely to sustain losses in terms of lost tariff revenue when they enter into preferential trading arrangements with very low tariff countries. As noted by Panagariya, “under such circumstances, the FTA amounts to [no more than] one-way preferences in which the high-tariff country loses and low-tariff country gains”.⁶¹

It follows from the above analysis that B would gain more, at least indirectly, if it were to extend the benefit it gave to A on an MFN basis. Thus instead of A capturing a significant share of B’s market by reason of the tariff preferences enjoyed exclusively by it, C would also receive the same treatment. This would intensify competition and drive down prices, as producers in all the three countries would wish to re-position themselves and take advantage of the new opportunities. In such a scenario, the consumers in B would be the main beneficiaries. Although, the government might lose part of its tariff revenue, it would indirectly achieve some positive gains such as improved efficiency.⁶²

3.1.1.1 Limitations of Viner's theory

Notwithstanding the different theoretical projections on the welfare effects of regional trade agreements, trade economists are agreed that the question as to whether a regional trade agreement is welfare-enhancing cannot be answered in the abstract.

⁶⁰Panagariya (1999) p484.

⁶¹*ibid* at p485.

⁶²*ibid*.

Viner himself noted that the many questions that he raised about customs unions could not be answered *a priori* and that the correct answers depended on how they operated in practice. An empirical assessment of regional trade agreements that are currently in force tend to support the view that these agreements have created more trade instead of diverting trade, thereby increasing global welfare. As noted by Professor Baldwin, "[a]lmost all empirical studies of European and North American arrangements find positive impacts on members' living standards and inconsequential impacts on nonmembers' living standards."⁶³ According to Laird, "[t]his derives from the fact that the larger share of international trade is in manufactures which have relatively high elasticities of import demand and supply, coupled with low elasticities of substitution (Armington elasticities) between alternative suppliers."⁶⁴

On the basis of contemporary trade theory, Kemp and Wan argue that "... there is a big incentive to form and enlarge a customs union until the whole world is one big customs union, that is, until free trade prevails."⁶⁵ This view is shared by Sam Laird, who notes that:

"From the basic trade theory, it is possible to set out a number of conditions for enhancing the welfare gains from a regional integration agreement. In comparative static terms, starting from a restrictive trade regime, individual members of a regional agreement increase their welfare directly in relation to the increase in imports resulting from the reduction of their own trade barriers against other members of the agreement. Moreover, trade creation and welfare gains will be greater, the higher the trade barriers being reduced, the higher share of pre-existing trade between the partners, the larger the partner countries, the more diversified partner countries' economies and the closer their prices resemble world prices. It can also be shown that the gains will also be higher, the greater the initial non-uniformity of the tariffs of the members."⁶⁶

Some economists have questioned the relevance of Viner's theory when parties to the regional trade agreement are "natural trading partners". That is to say that the countries that are very close geographically (neighbours) and trade substantially with each other. With such natural trading partners, it has been argued trade diversion would be very minimal, as the conclusion of the regional trade agreement would not significantly affect the volume of trade between the parties, especially where they

⁶³Baldwin (1997) p865

⁶⁴Laird (1999) p1180.

⁶⁵Kemp and Wan (1976) p96.

maintained very low tariffs prior to the formation of the regional trade agreement. The example is usually given of Canada and the United States, which were each other's largest trading partner even before the free - trade agreement between them went into force in 1987.⁶⁷ Professor Summers, who is a proponent of this theory, has argued that "the issue of natural trading blocs is crucial because to the extent that blocs are created between countries that already trade disproportionately, the risk of large amounts of trade diversion is reduced".⁶⁸

This view has, however, been vigorously challenged by Professors Bhagwati and Panagariya who argue that the trade-diversionary effects of regional trade agreements cannot be disparaged and that the natural trading partners hypothesis has no analytic and solid basis. Panagariya, in a robust critique of Professor Summers, has argued that:

"According to Summers' definition, the United States may be the natural trading partner of both Mexico and Canada but these two are not natural trading partners of each other...Trade diversion is a marginal concept and, therefore, has nothing to do with the initial level of trade. While the scope for trade diversion may depend on the extent of intra-union trade, the actual trade diversion depends entirely on the response of partner country's exports to the tariff preference at the margin...If a country forms a regional trade agreement with another country with substantially lower tariffs than its own, its losses are larger the more it imports from the partner. Because weaker, uncompetitive industries are usually the ones that succeed in lobbying against foreign competition, regional trade agreements get voted in precisely when trade diversion is the dominant force...The tariff phase out in NAFTA shows that the sectors which were allowed the longest phase out periods in the United States were the ones in which import-competing lobbies were the strongest. More direct empirical evidence supporting trade diversion is also beginning to accumulate. A recently, widely-publicized, World Bank study by Yeats provides systematic evidence of wholesale trade diversion in MERCOSUR. Similarly, Wei and Frankel find that various extensions of the European Community were accompanied by a considerable trade diversion. Imports from non-member countries in 1990 were 30 % lower than in 1980. after

⁶⁶Laird (1999) p1180.

⁶⁷Professor Summers, writing in support of this position, queried: "[a]re trading blocs likely to divert large amounts of trade"? In responding to the question himself, he observed that "the issue of natural trading blocs is crucial because to the extent that blocs are created between countries that already trade disproportionately, the risk of large amounts of trade diversion is reduced": "Regionalism and the World Trading System", paper presented in 1991 at the Symposium on "Policy Implications of Trade and Currency Zones" sponsored by the Federal Reserve Bank of Kansas City quoted in Panagariya (1999).

⁶⁸Summers, *ibid.*

controlling for economic growth. Thus, the possibility of trade diversion cannot be taken lightly".⁶⁹

It is quite clear from the examinations conducted in the past by Working Parties and the recently established Committee on Regional Trade Agreements that Members of the WTO are concerned about the trade diversionary effects of regional trade agreements. In other words, notwithstanding the limitations of Viner's theory and its non-incorporation into the terms of Article XXIV, it still remains the yardstick against which regional trade agreements are measured by several Members of the WTO to determine whether they are welfare-enhancing and consistent with the rules of the WTO. A regional trade agreement which results in massive trade diversion is likely to be viewed in the WTO by most Members as not being consistent with the provisions of Article XXIV. On the contrary, if trade with third countries does not diminish after the formation of a regional trade agreement, then a stronger argument could be made that the agreement is welfare-enhancing and consistent with the multilateral rules.⁷⁰

3.1.2 *Investment Creation and Investment Diversion*

Whereas the focus of Viner's theory was principally on the trade effects of regional trade agreements, it has been suggested that his theory can also be extended to investment flows, as it is now difficult to separate trade from investment. According to the WTO studies, over 50 per cent of world trade is being conducted by multinational corporations and their subsidiaries and foreign affiliates. The higher percentage of intra-trade demonstrates the growing indivisibility between trade, investment, and

⁶⁹Panagariya, *ibid* at pp485-486. He estimates that the redistributive effect may be costing Mexico as much as \$3.25 billion per year.

⁷⁰See the report on the Examination of the Enlargement of the European Union: Accession of Austria, Finland and Sweden (WT/REG3/M/1; 23 April 1997), para. 27 at p6. The representative of Hong Kong stated that "it was important to establish whether an agreement created or diverted trade. An agreement would usually be consistent with the provisions of Article XXIV if it created trade; if it diverted trade, it might not be consistent with the multilateral rules". See further the comments of the Malaysian representative during the Examination of the Goods Aspects of the North American Free - trade Agreement: "in the wake of the proliferation of regional groupings and free - trade areas, the challenge for those embarking on such ventures was not only to ensure that they were in full conformity with the provisions of the WTO, but also to ensure that such arrangements were outward-looking. While preferential trade liberalization would certainly benefit the NAFTA members, there was the potential for trade and investment diversion, especially in the sectors where stringent rules had been provided": WT/REG4/M/1; 21 February 1997, para. 17 at p4.

technology decisions in today's global economy.⁷¹ It is also true that countries which attract substantial amounts of foreign direct investment participate more effectively in the multilateral trading system. This is especially true in the case of developing countries such as Brazil, China, India, Singapore, Hong Kong, China, Taiwan and the Republic of Korea.

The formation of a regional trade agreement is likely to affect investment flows within and outside the region, especially where the participating countries are important trading nations. Investment creation would take place when, as a result of competitive conditions in a participating member country in terms of the regulatory framework, productivity, labour costs, efficiency and other important considerations, firms in other participating member countries instead of not investing at all or investing in their home countries decide to invest in it. In other words, the decision to make an investment will be based on commercial considerations instead of allegiances or other political considerations. As stated in the WTO study:

"Because preferences alter the incentives facing firms, both those located within the preferential trade area, and those located within the preferential trade area and those located outside, the formation of a regional integration agreement is likely to influence direct investment flows. This will be true even if it does not change the regulation of investments...Firms located in third countries will have an incentive to locate new production facilities in a member country and service the other members of the regional integration agreement through intra-area exports. To the extent that there are increasing returns to scale, the creation of a larger integrated market in conjunction with an increase in competition will lower unit production costs, and increase the attractiveness of establishing within the region. Similarly, the effects of intra-area liberalization on the growth of per capita incomes will further increase the incentive for inward foreign direct investment, to the extent that this leads firms to anticipate market growth and perhaps further reductions in unit costs. Moreover, if the formation of a customs union involves the conversion of non-tariff measures discriminating in favour of national firms into region-wide preferences, the advantage of locating inside the union will increase further...".⁷²

Investment diversion is likely to occur in any of the following situations: First, when as a result of the formation of a regional trade agreement, companies situated in a participating member country instead of investing in a non-participating country decide

⁷¹See generally WTO (1996) pp44-78.

⁷²WTO (1995) p46. See further Balasubramanyam and Greenway, (1993) and OECD. (1995) pp55-60.

to invest in a partner country in order to take advantage of special preferences accorded only to partner countries including tariff preferences.⁷³ When a participating member country has very restrictive investment laws and regulations, it is likely that it will increase the amount of investment diversion, as firms situated in partner countries would wish to take advantage of the relaxation of the rules and regulations governing investment, especially where the market opportunities in that country are significant. This would represent lost opportunities for third countries which may have received those "diverted" investments.

The second instance would be where there is the perceived threat that after the formation of a customs union or a free - trade area, the member countries would adopt policies which would seek to expand regional production and secure favourable terms of trade. Empirical studies indicate that foreign direct investment flows to the European Community increased significantly after the announcement of the Single Market initiative:

"Statistics on foreign direct investment into the European Community following the announcement of the Single Market program in 1985 provide prima facie support for the view that the impact has been large. Total inflows of foreign direct investment into the member countries expanded dramatically after the mid-1980s, rising from ECU 10 billion in 1984 to ECU 63 billion in 1989...Whereas in 1984 total flows into the European Community were about one-third the size of those going to the United States, by 1989 the size of direct investment flows were roughly the same. Intra-EC flows also grew faster than inflows from third countries. The former registered an annual average annual growth rate of 43.5 per cent during 1985-89, as compared to 28.6 per cent for the latter. In comparison, direct investment flows into the United States grew on the average by 14.8 per cent per year during that period".⁷⁴

Where the agreement sets up a free-trade area and has very stringent rules of origin, it is likely that third countries would attempt to get around the new rules by investing in the free - trade area, especially in the country with the lowest external tariffs or where the cost of production is lower and service the other participating countries from its base. To counteract trade deflection, parties to free - trade areas

⁷³WTO, *ibid*. The Secretariat notes that "[t]o the extent that the increased investment is not financed from a higher rate of saving in the area or elsewhere, it must divert foreign direct investment flows away from one or more destinations outside the regional integration agreement".

usually adopt stringent rules of origin to determine the “nationality” of the imported product before conferring preferential treatment.

As the WTO does not have uniform rules on preferential and non-preferential rules of origin, Members have devised and applied their own rules having regard to internationally accepted practices in this area. Usually, they may apply any of the following criteria to determine the nationality of a product so as to accord preferential treatment. First, the rules usually require goods which are not wholly obtained in a participating country to undergo a “substantial transformation process” in order to be eligible for tariff preferences. A product would normally be deemed to have satisfied this test, if it had undergone further processing or refinement as to change its tariff classification. Thus, simple processes carried out in the regional trade agreement would not make the product eligible for preferential treatment. Affixing, for example, a label to the product would not change the essential character of the product as to render it eligible for preferential treatment.

Second, the rules might require that for products to be eligible for preferential treatment, non-regional inputs or components should not exceed a certain percentage of the total production cost of the product or its transaction value. The effect of such a rule is that it would encourage the use of regional inputs or components, even if they are not competitive in terms of price and quality. Lastly, the rules might stipulate that for a product to be eligible, it must have undergone some specific processes within the regional trade area or that some other product-specific technological requirements be met.

The possibility of Members of the WTO using rules of origin as a disguised restriction on trade has long been recognised and it is one of the systemic issues being considered by the newly created WTO Committee on Regional Trade Agreements. The following example given by the WTO Secretariat highlights how they could become instruments for the diversion of trade and investment:

"While the basic purpose of rules of origin is to prevent trade deflection, rules of origin in and of themselves may also lead to trade diversion. For example.

⁷⁴*Ibid* at p47.

under NAFTA rules of origin, clothing produced in Mexico gains tariff-free access to the United States market, provided it meets the "yarn forward" rule, which for many products requires virtually 100 per cent sourcing of inputs in North America. Mexican clothing manufacturers face a choice between sourcing all inputs beyond the fibre stage in North America and obtaining free - trade treatment, or sourcing inputs outside the free - trade area at potentially lower cost, but foregoing duty-free access to the United States and Canada. If profits are higher under the first option, Mexican clothing manufacturers will opt for the North American status and stop buying from lower-cost third-country suppliers...[T]he more restrictive the rule of origin, the greater the scope for trade diversion involving intermediate products-up to the point where the origin rule becomes so restrictive that producers opt for the second option".⁷⁵

3.2 *Traditional (Static) Reasons*

3.2.1 *Efficiency Considerations*

Perhaps the main motivation for the formation of regional trade arrangements is the belief that such arrangements would enhance the competitiveness of the participating countries and increase economic efficiency.⁷⁶ The formation of a free-trade area or a customs union increases the size of the market and promotes competition between firms located within one country and also among those in partner countries. The increased size of the market would intensify competition, as firms position themselves to increase their market share, which would in turn lead to greater productive efficiency for any industry which would successfully adjust by streamlining and consolidating its operations. It has been suggested that the EEC succeeded because its member states were able to take advantage of the opportunities offered by an integrated economy:

"When the European Common Market was formed in 1958, substantial trade diversion seemed a likely outcome. What turned the arrangement into a strong economic success was the huge intra-industry trade in manufactures, and the associated rationalization of production, that the Treaty of Rome made possible".⁷⁷

It is generally acknowledged that in the less-developed areas of Asia, Latin America and Africa, integration is driven by a desire to achieve the means to improve

⁷⁵*Ibid* at p48.

⁷⁶See generally OECD (1996) and OECD (1995).

⁷⁷Fernández (1997). See further Frankel (1997) pp4-5.

the participation of (some times smaller) countries in the global economy. As rightly observed by the Director-General of the WTO, Mr. Mike Moore:

"Regional trade agreements can be a good thing ... Creating a single regional market can increase economic efficiency. Regional trade agreements, in tandem with multilateral liberalisation, can also help countries – particularly developing countries – build on their comparative advantages, sharpen the efficiency of their industries, and act as a springboard to integration into the world economy."⁷⁸

To the same effect is the following statement by the OECD:

"Regionalism is thought to help foster a more stable and predictable environment for the partner countries, to allow for greater specialisation and to encourage rationalisation of the industrial structure within the region, which would be of benefit to each member of the region as a whole. In many developing countries, the notion is widely held that regional integration is a precondition for long-run growth since national markets are incapable of providing the necessary size to exploit economies of scale and specialisation".⁷⁹

3.2.2 *Trade Expansion*

Another “traditional” reason which has been advanced to encourage the formation of regional trading arrangements is that it would lead to an expansion in the volume of trade of the participating countries and improve their terms of trade.⁸⁰ This is likely to occur as a result of the substitution of high cost producers in the region with low cost producers. While this process may result in a negative impact on third countries as it would impact unfavourably on their terms of trade, it may bring a number of advantages to members of a regional economic grouping. Should the volume of trade among the participating countries increase, consumers would enjoy a wider variety of goods, and also pay affordable prices for them, as the effect of increased competition and the reduction or abolition of tariffs would be to drive down prices and encourage innovation.

Some of the benefits which may accrue to the participating countries may be short-term, and unless they adopt outward-oriented policies, they would cease to realise

⁷⁸Moore, *supra* note 7 at p3.

⁷⁹OECD (1993) p25.

⁸⁰Frankel et al. (1997) pp190-192.

the full benefits from integration. This includes extending the benefits to other Members of the WTO. The very fact that there is increased trade between the participating countries does not necessarily mean that the arrangement is welfare-enhancing. The elimination of tariffs on the products originating in the "single customs territory" will increase trade, especially when tariffs maintained against the outside world are very high. A switch from a relatively lower cost producer (a third country) to a higher cost producer because of tariff preferences has the potential of decreasing welfare and impacting negatively on world efficiency, as has been demonstrated in the classical analysis of Jacob Viner and other subsequent studies.

3.2.3 *Means of Attracting Foreign Direct Investment (FDI)*

The presence of an integrated market, the adoption of outward oriented policies and other conducive macroeconomic policies are some of the key determinants of foreign direct investment. A carefully planned regional trading arrangement could be a powerful tool for attracting investment. Empirical evidence to date suggests that some regional groupings, particularly the European Union, NAFTA, ASEAN and MERCOSUR, have been successful in attracting substantial investments over the years. Investors are likely to be encouraged to invest in a customs union or a free - trade area for two main reasons: the increased size of the market and the possibility of sourcing cheaper inputs within the region. These appeal to foreign and domestic investors who are always seeking greater returns on their investment.

Foreign investors are also likely to be influenced in their decision to invest in the region by concerns relating to market access after the formation of the regional trading arrangement. If the indications are that the group will adopt and implement protectionist policies, it is likely that there will be a surge in foreign direct investment, as happened in the context of the European Union, after the announcement of the "single market" initiative.⁸¹ As Raquel Fernández notes, a regional trading arrangement could:

⁸¹The fears of foreign investors were unfounded, as Europe continued to maintain a relatively open trading and investment regime after the implementation of the "single market" programme.

”stimulate investment flows both *between* its constituent member countries, and from outside the RTA, in a number of ways: by reducing distortions in production within the two countries, it could increase the overall quantity of investment made by investors in member countries; by increasing the size of the potential market, it could increase the quantity of investment made both by domestic and outside investors. This effect is particularly important for “lumpy” investments like a factory, that might only be economic above a certain size; and in the case of a customs union, by creating a single market within a common external tariff wall, it may increase the incentive for foreign investors to engage in “tariff jumping”, if the common external tariff is higher than pre-existing tariff for some individual member”.⁸² (italics in original)

III.2.4 *Political Considerations - Confidence Building*

If two or more countries should decide to form a customs union or a free - trade area, they would be obliged to abolish almost all restrictions relating to their trade, and depending on the sort of arrangement envisaged by the parties, adopt a common external tariff.⁸³ The participating countries may also want to abolish all restrictions relating to the free movement of capital, workers and the right of establishment. They may even decide to harmonise their monetary, fiscal and economic policies, as it is envisaged in the European context. Thus, by their very nature, regional trading arrangements tend to encourage and promote friendly relations between partner countries.

Goods produced in the constituent territories would have free circulation within the customs territory with very limited exceptions such as for reasons of public health and morality. The destiny of the countries would become more and more intertwined. Political tensions would be reduced, and eventually replaced by good neighbourliness. This confidence-building role of regional trade agreements is necessary for economic growth and prosperity. The European Economic Community was formed primarily because of the desire to reduce tensions between European countries, particularly Germany and France and avoid the breaking out of hostilities again. An essential element of the common currency project is to bind the European countries and peoples ever closer. Some analysts expect that the introduction of the single European currency could pave the way to political and economic union.

⁸²Fernández (1997) pp6-7.

⁸³It is noteworthy that Article XXIV of GATT 1994 defines a customs union as “the substitution of a single customs territory for two or more customs territories”.

3.2.5 *Easy Accession and Administration*

The WTO Secretariat estimates that nearly 170 regional trade agreements have been concluded, half of these since 1990.⁸⁴ One reason why countries are interested in joining regional trading arrangements is the relative ease at which they can accede to such arrangements, and the possibility of reaching agreements on a broad number of subjects within a relatively short space of time. Negotiations conducted in the WTO are often very complex with more than 140 countries participating in them, making it extremely difficult to reach agreement.

"Like-minded" countries which are roughly at the same level of development are more likely to reach agreement which would further their interests than countries at very different levels. It was the difficulty to achieve an agreement on investment at the multilateral level that gave the impetus for the CECD countries to attempt to negotiate an agreement among themselves and later explore the possibilities of concluding a multilateral agreement under the auspices of the WTO.⁸⁵ The same is true of the development of guidelines on export credits.⁸⁶ OECD Members of the WTO believe that it would be easier to reach agreement in the OECD and later multilateralise it under the auspices of the WTO, but developing countries are circumspect about that reasoning. They insist on having a role in the development of the initial rules and concepts rather than being presented with a *fait accompli* at a later stage.

3.3 *Non-Traditional Benefits of Regional Trading Arrangements*

⁸⁴WTO Secretariat, (2000b) p3. See further Moore Mike, *supra* note 7 at pp1-2.

⁸⁵The OECD members have put off their attempts to reach an agreement on investment. It is reported that the negotiations failed, *inter alia*, because of differences on how to deal with exceptions to the non-discrimination principle, particularly preferences given by members of a regional trading group and how to protect sensitive industries such as cultural industries. Various NGOs were also critical of the proposed Agreement.

⁸⁶Article 10.2 of the Agreement on Agriculture provides that "Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith".

The continued proliferation of regional trading arrangements, notwithstanding the achievements of the Uruguay Round has forced commentators to look beyond the traditional reasons for an explanation of the present trend. As previously noted, at the height of the Uruguay Round negotiations, there was a dramatic increase in the number of regional trade agreements which were notified to the GATT. It has been suggested that the proliferation owed very much to the fear that the negotiations were going to collapse, as it had seemed throughout the negotiations.⁸⁷ If this explanation is plausible, then why has the trend continued well after the implementation of the results of the Uruguay Round and when there are plans underway to further strengthen the multilateral trading system by launching a new trade round of negotiations? Recent initiatives which have been proposed including the Asia Pacific Economic Cooperation (APEC), the Free - trade Area of the Americas (FTAA) and the Trans-Atlantic Free - trade Area linking the European Union and the North American Free - trade Agreement seem to cast doubt on this theory. As observed by the then Director-General of the WTO in a speech to the 3rd Conference of the Transatlantic Business Dialogue in Rome:

“the central argument for regionalism has always been that smaller groups of countries may be able to move further and faster towards integration than in a much wider multilateral system. But this logic still lies behind the vast regional arrangements we see unfolding around [the world]. For one thing, it is very difficult to make the argument that liberalization is any easier in, say, APEC, the FTAA or between the EU and the Mediterranean countries, than in the WTO. Many of these new regional arrangements contain countries as different in outlook, economic size and level of development as any countries in the multilateral trading system. And the points of trade friction are no less vexing. For example, are negotiations between Japan and the United States really any easier in APEC than in the WTO? Can Europe resolve the issue of agricultural liberalization any more swiftly transatlantically with MERCOSUR, or across the Mediterranean with the countries of the Middle East and North Africa?”⁸⁸.

⁸⁷Snape, Adams and Morgan (1993) p3.

⁸⁸Ruggiero (1997), "Regional Initiatives, Global Impact: Cooperation and the Multilateral Trading System", speech delivered in Rome, p2. See further the editorial in the *Financial Times*, Tuesday, 20 February 2001: "A [new trade] round would offer a far greater potential pay-off than a hemispheric trade agreement...Instead of struggling to liberalise Latin American markets that account for less than 6 per cent of world imports, Washington... [should] be engaging in a concerted drive to lower trade barriers by 140 countries, likely soon to be joined by China. A WTO deal would also be underpinned by enforceable rules...In the interests of the US and of the world, [President Bush] should put global liberalisation first. FTAA can wait until later."

As this statement indicates, it is difficult to ascertain what is driving the formation of regional trading arrangements in contemporary times. It could well be a mix of the traditional and non-traditional reasons, some of which are considered below.

3.3.1 *Credibility to Domestic Reforms*

The 1980s witnessed the adoption of unilateral trade liberalization measures by a significant number of developing and smaller countries.⁸⁹ To give credibility to their domestic reform programmes, a number of them sought to anchor their reforms to the GATT system or regional groupings. The reason behind this approach was to convince actual and potential trading partners, that they were committed to reform. A number of studies indicate that one of the major reasons why African countries have failed to attract foreign direct investment is because of the continual reversal of policies by successive governments. This creates uncertainty and accentuates the lack of confidence in investors.⁹⁰

Whereas it may be relatively easier for a country which is not a party to a bilateral/regional trade agreement to discard its reform programme when demands are made on it by domestic interest groups and lobbies, it would be restrained when it is a member of the WTO or a regional group, as non-implementation of its obligations could provoke retaliatory measures by its trading partners. In effect, participation in a regional/multilateral trade arrangement could bolster investor confidence and send a signal to the international trading community about the commitment of a country to trade policy reform.

3.3.2 *Locking in of Domestic Reforms*

Increasingly, a number of developing countries are entering into regional trading arrangements with developed countries, such as Mexico joining Canada and the United States in NAFTA, and Papua New Guinea joining Japan, Canada, the United States, Australia, New Zealand and other advanced developing countries including Singapore and the Republic of Korea in APEC. The African Growth and Employment Act which

⁸⁹See generally Bhagwati (1997). See further Serra et al. (1997).

⁹⁰Oyejide (1997) p32.

gives trade preferences to African countries which implement sound economic reforms, and the proposed regional partnership agreements between the European Community and regional economic groupings in African, Caribbean and Pacific (ACP) countries are indicative of this trend. Given the relative economic power and influence wielded by their trading partners, developing countries are more likely to respect the rules of the regional trading arrangement, as they cannot afford to provoke a crisis in the arrangement.

In the event of the arrangement disintegrating, developing countries could come out worse-off, as they could lose their preferential market access, which could hurt their economies, especially where the bulk of their exports go to their former partner country and if the MFN rates on products of export interest to them are high. They could also experience some investment diversion, as investors from third countries which invested there with the hope of benefitting from the preferential rates of duty and other benefits may relocate elsewhere. Investors from the developed country who may have invested in the developing country in order to take advantage of lower wages and manufacturing costs may also disinvest, if they have to face higher MFN tariff rates. After the formation of NAFTA, there was a lot of trade and investment diversion to Mexico from Latin American and Caribbean countries, as investors sought to use it as a base for supplying the whole North American market. It is doubtful whether Mexico would continue to attract significant amounts of investments, should it cease to be a member of NAFTA.

By entering into preferential trade arrangements with developed countries, it is the belief of developing countries that it will help them to resist demands of lobbyists by pointing out that they have entered into a legally binding agreement whose provisions must be respected, otherwise action could be taken against them by the other members of the trade arrangement. Furthermore, countries which realise the benefits from trade liberalisation are emboldened to further liberalise their markets and pursue outward-oriented policies.⁹¹

3.3.3 *Increased Negotiating Leverage in the WTO and other Fora*

⁹¹*ibid.*

One of the benefits of regional trading arrangements is that they could enhance the negotiating influence of their members in economic, trade and political matters. Individually, they may not be able to influence the direction of multilateral trade negotiations. However, if they are negotiating collectively, it would be difficult for their negotiating partners to ignore their position on a number of subjects. If the participating countries are developing countries, it would be easier for them to request and be granted technical assistance by the WTO and other international institutions including the World Bank, UNCTAD and the ITC. Such assistance could be provided to help them meet their notification obligations under the WTO Agreement, and also their obligations under the TRIPS, TBT and SPS Agreements. Most international institutions and donor countries find it more cost-effective to provide assistance at the regional level than on a national level.

For smaller and weaker countries, it could be the fear of marginalisation which drives them to cooperate on trade and other related issues at the regional level with neighbours. Put in another way, it is their belief that regional arrangements could provide a more effective counter-weight to other trading blocs and enable them to negotiate with such blocs on an equal footing and be in a stronger position to take retaliatory action, if need be. As noted in a report prepared by the Global Coalition for Africa:

“These economic blocs are a response to the globalization of the [world economy]. The loss of State sovereignty (weakening of monetary, budget and trade instruments) leads governments to attempt to regain control of economic policy by joining a regional grouping. For example, a single European currency appears to have greater chances of stability, and therefore of independence from the financial markets, than the European currencies individually. *Similarly, the countries joining a customs union increase their international negotiating hand.* First, they become a bigger market and can retaliate more effectively in case of trade disputes. Second, they can act together to adjust their common external tariffs and pass [on the resulting costs to third countries]...In this way, they can set optimal tariffs for their members, as long as they organise transfers within the union for the countries that lose out...Regional blocs may also be preferred forums for negotiating social and environmental standards and collective preferences on which [it would be difficult to achieve] an international consensus”.⁹² (italics added)

It is evident from the foregoing that, a forceful argument can be made that Members of the GATT/WTO that are rushing to join or form regional integration agreements are being motivated by reasons that are not wholly connected to tariff-preferences, as was the case for the first wave of regional trade agreements which were entered into in the first three decades after the creation of the GATT.⁹³

Most countries are hopeful that by joining such blocs, their exports will be exempted from the new protectionist tools that are increasingly being used by countries to protect their domestic industries.⁹⁴ Some are impatient with the slow progress being made on the multilateral front to bring important subjects such as investment, antitrust, environmental and labour standards under international regulation, while others believe regionalism would give them the opportunity to attract investment and enjoy economies of scale.

Whereas it is difficult to criticise the underlying reasons for the surge in the number of regional integration agreements, the fact remains that they have the ability to divert trade from countries which are not parties to such agreements. Countries which acceded to the GATT/WTO had a reasonable expectation of receiving equal treatment, not discrimination, from their trading partners. It is doubtful whether many contracting parties of GATT/WTO would have acceded to the General Agreement, had they known that Article XXIV would be used by some members to undermine the most-favoured-

⁹²Global Coalition for Africa (1995) p16.

⁹³As noted by Sampson (1994) p50: "Given the results of the Uruguay Round in lowering tariffs - and in the case of agriculture - non-tariff barriers to trade, the motivation of joining preferential trading arrangements must lie somewhere other than in preferential market access through tariff preferences. Even with the reduction of agricultural barriers, the impediments remain high, but in any event, agriculture as a sector has normally been kept outside the "substantial" reduction in trade barriers in the in the various agreements...Thus what will be the nature of preferences in future trading arrangements and how will preferences that have been reduced or removed as a result of the Uruguay Round be restored in existing agreements. One possibility is the proliferation of "contingent" or "administered" protection vis-a-vis non-parties to the regional trading arrangements."

⁹⁴The Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), is indicative of the trend that is now emerging. The Agreement, which was concluded in July 1990, provides for the suspension of all antidumping actions and the termination of any antidumping duties in force. In their place have been substituted harmonised provisions in both countries' competition laws relating to abuse of dominant position.

nation clause. As noted by Japan in its submission to the Negotiating Group on GATT Articles during the Uruguay Round:

“While regional arrangements such as customs unions and free - trade areas constitute a major derogation from the most-favoured-nation treatment, which is one of the basic principles of the General Agreement, they have been established in an increasing number and have grown in their size and scope since the establishment of the GATT, surpassing all expectations on the size and scope held at the time of the drafting of the General Agreement. Today, the regional arrangements have covered a significant proportion of world trade. In other words, a large part of world trade today is not being transacted upon the principle of most-favoured-nation treatment”.⁹⁵

The obvious danger from the proliferation of regional arrangements is that if their effects on third countries are not minimised, they could lead to an increase in trade frictions among states with the probable result of increased protectionism, which would in turn impoverish the world and endanger peace and security. That regional trading entities should be strictly monitored to ensure that they operate in accordance with the multilateral rules embodied in the General Agreement is not doubted by any Member of GATT/WTO. The WTO Secretariat, which has stated that “it is plausible to conclude that post-war regional integration agreements have had an overall positive effect on the pace of international economic integration or at least that they have not slowed it down”,⁹⁶ has come out strongly for the strengthening of Article XXIV. In a speech to the Argentinian Council on Foreign Relations, the then Director-General of the WTO stressed the importance of safeguarding the primacy of the multilateral trading system:

“Regional arrangements have provided stepping stones to global liberalization, they have served as important crucibles for trade policy innovation, and they can be a source of creative tension in the system as a whole, forcing the pace of other regional and multilateral initiatives. *My concern is not so much that regional arrangements will turn inward, but that their very momentum will leave the multilateral system behind. If regional liberalization outstrips the WTO process, there is the danger that we will lack a common framework of rules and disciplines. If our economic interests are increasingly defined regionally and not globally, it will be more and more difficult to find the critical mass of countries needed to sustain the multilateral system. The risk then is of a fragmented world—one which fosters inter-regional frictions and rivalries. but*

⁹⁵Article XXIV, Submission by Japan, GATT Doc. No. MTN.GNG/NG7/W/66 (22 Dec 1989) p1.

⁹⁶WTO (1995) p64.

lacks the global architecture of rules and procedures needed to manage them."⁹⁷ (italics added)

The rules of the WTO, which were designed to ensure the complementarity of preferential trade arrangements with the multilateral trading system, are examined in the next two chapters.

Chapter 4

Relevant Multilateral Rules on Regional Trade Agreements

Members of GATT/WTO can form regional trading arrangements either pursuant to Article XXIV of GATT 1994, Article V of the GATS or the Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries ("the Enabling Clause"). Where the conditions of these Articles cannot be fulfilled, a waiver could be obtained from the Members under Article IX of the Marrakesh Decision Establishing the WTO to establish a regional trading arrangement, such as the Lomé Convention. The WTO Secretariat estimates that nearly 170 regional trade agreements have been concluded by countries, half of these since 1990.⁹⁸ It is important to point out that not all agreements are notified to the GATT/WTO. Some Members of the WTO neglect to notify their agreements, while countries which are not Members of the WTO have no obligation to notify.

It cannot be doubted that if the dynamism of the multilateral trading system is to be preserved, the rules on regional trading arrangements have to be interpreted strictly

⁹⁷Ruggiero (1996) "Beyond Borders: Managing a World of Free-trade and Deep Interdependence", speech delivered in Buenos Aires, p3. See further paragraph 7 of the Ministerial Declaration, WT/MIN(96)/DEC, "We note that trade relations of WTO Members are being increasingly influenced by regional trade agreements, which have expended vastly in number, scope and coverage. Such initiatives can promote further liberalization and may assist least-developed, developing and transition economies in integrating into the international trading system. In this context, we note the importance of existing regional arrangements involving developing and least-developed countries. The expansion and the extent of regional trade agreements make it important to analyse whether the system of the WTO rights and obligations as it relates to regional trade agreements needs to be further clarified. We reaffirm the primacy of the multilateral trading system, which includes a framework for the development of regional trade agreements, and we renew our commitments to ensure that regional trade agreements are complementary to it and consistent with its rules..."

and consistently. As will be demonstrated, these rules have been interpreted broadly and inconsistently that it is difficult to state categorically what the obligations of Members are under the rules of the WTO. Instead of developing a coherent body of jurisprudence which could have guided Members wishing to form regional trading arrangements, the Working Parties indirectly gave the signal that any agreement, once signed and implemented by the parties, could not be objected to by the GATT/WTO, even if some of its provisions were not fully consistent with the multilateral rules.

Unlike Panels established to settle disputes between Members, the Working Parties established under the GATT to examine the consistency of regional trade agreements with the relevant multilateral trade rules were open to all Members including those whose agreements were being examined. In other words, the process of examination to test the consistency of the agreements with the multilateral rules were not free from extraneous considerations such as national pride and politics. An examination of some of the reports of the Working Parties would reveal that in trade arrangements involving developing countries, the Working Parties were influenced by considerations relating to development. So far as it was perceived that the agreement might assist the countries to increase their participation in the multilateral trading system, little regard was given to whether the multilateral disciplines had been complied with by the parties.

To some extent, the same was also true for agreements involving developed countries. In the 1950s and 1960s, economic integration in Europe was seen as necessary to halt the spread of communism. The United States and other major non-European trading nations did not insist on full compliance with the terms of Article XXIV, as they thought that for geo-political reasons it was necessary in the interest of world peace and security to have a stable and prosperous Western Europe.⁹⁹ Thus, notwithstanding the difficulties that some Members had with the Treaty of Rome, the six original members of the EEC were not vigorously challenged when they implemented their agreement. Doubts about the consistency of the Treaty of Rome with the rules of the GATT/WTO still linger on, as the Treaty was never given a clean bill of

⁹⁸WTO (2000b) p3. See further speech delivered by Mike Moore, *supra* note 7 at pp1-2.

⁹⁹Frankel et al. (1997) p5. See further Snape, Adams and Morgan (1993) p6.

health by the GATT. As will be shown later, the examination of the Treaty exposed the ambiguity in the language of Article XXIV and set the stage for differing interpretations to be given to the provisions of Article XXIV by Members of the WTO.

4.1 *Article XXIV of GATT 1994*

The starting point for any study on regional integration agreements in the WTO context is Article XXIV of the GATT 1994. This Article essentially provides legal cover for Members of the WTO to form or join customs unions or free - trade areas, provided that their “purpose [is] to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories”.¹⁰⁰ Paragraph 8 of Article XXIV makes it clear that the WTO rules only apply to customs unions, free - trade areas and interim agreements for the formation of free - trade areas and customs unions. Thus, the rules do not cover agreements establishing common markets and economic unions.¹⁰¹

A customs union is defined as the "substitution of a single customs territory for two or more customs territories, so that (i) duties and other restrictive regulations of commerce (except where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and (ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union“.

By way of comparison, a free - trade area is defined as "a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories“.

¹⁰⁰See Article XXIV: 4 of the General Agreement.

¹⁰¹Frankel et al. (1997) pp13-17.

Thus, the basic difference between a customs union and a free - trade area is that while under the former, the parties are obliged to apply "substantially the same duties and other regulations of commerce", they are not obliged to do so in a free - trade area. Put simply, each constituent member has the right to retain its external tariffs on the trade of non-constituent members. As mentioned earlier, because of the possibility of trade deflection to the party applying the lowest common external tariff, parties to free - trade areas usually apply stringent rules of origin.

The following section examines the provisions of Article XXIV and the interpretative problems which have been encountered by GATT/WTO Working Parties and the recently established Committee on Regional Trade Agreements and suggests how they might be strengthened. The provisions of Article XXIV:4 - 6 are examined below, while those of Article XXIV:6 - 8 are examined in Chapter 5.

4.2 *Examination of the Provisions of Article XXIV:4-5 of the GATT1994*

4.2.1 *The scope of Article XXIV:4 and its relationship with other provisions in Article XXIV of GATT 1994*

The issue as to whether the requirements of Articles XXIV:4 and XXIV:5-9 are mutually exclusive or supportive in the sense that parties to regional trade agreements are not expected to comply with the conditions set out in those two articles has long been debated by academics and Working Parties without any clear result. As was aptly put by Hong Kong in a communication to the Committee on Regional Trade Agreements, "[t]he uncertainty is whether this provision should be regarded as being in the nature of a preamble or whether the injunction "not to raise barriers to the trade of (third parties)" can be applied objectively."¹⁰²

In the review of the Treaty of Rome, members of the European Economic Community (EEC) argued forcefully before a sub-group of the Working Party that the only requirements which had to be complied with by Members wishing to form free -

¹⁰²See WTO Document WT/REG/W/31; 18 November 1998, p1.

trade areas or customs unions were paragraphs 5 to 9 of Article XXIV, as paragraph 4 thereof did not lay down any positive obligation on Members:

“The terms of paragraph 4 on the one hand, and paragraphs 5 to 9 on the other must be interpreted interdependently. Paragraph 5 of Article XXIV starts with the word “accordingly” which indicates beyond doubt the relationship which exists between these two sets of provisions. The conditions laid down in paragraphs 5 to 9 have the purpose of ensuring that customs unions or free - trade areas are in conformity with the general principle laid down in the second sentence of paragraph 4. In other words, a customs union or a free - trade area which fulfil the requirements of the provisions of paragraphs 5 to 9 of Article XXIV would automatically and necessarily satisfy the requirements of paragraph 4 since paragraphs 5 to 9 merely spell out the implications of paragraph 4. This interpretation is confirmed by the records of the preparatory work related to the adoption of the text of the present Article XXIV”.¹⁰³

This interpretation was not shared by some members of the Working Party, who were of the view that the second sentence of paragraph 4 created a separate obligation in addition to those laid down in paragraphs 5 to 9:

“Most members of the Sub-Group were not prepared to accept this interpretation. They believed that paragraph 4 establishes the basic principles which a customs union should apply to be consistent with the objectives of GATT. Where questions arise as to the application of the provisions of paragraphs 5 to 9 in particular cases, such questions should be resolved in a manner consistent with the principles embodied in paragraph 4. Some members of the Sub-Group felt, furthermore, that the CONTRACTING PARTIES would have to verify whether the application of paragraphs 5 to 9 is consistent with the aim of a customs union as defined in paragraph 4”.¹⁰⁴

The reason for the divergent opinions is quite clear: if paragraph 4 is accepted as imposing a separate and an additional obligation, members of a customs union or a free - trade area may be obliged not to raise barriers to the trade of any individual Member of the WTO. In other words, in assessing the impact of a customs union or a free - trade area, an aggregated analysis should be eschewed, as it may conceal the real impact of

¹⁰³The Working Party Report (L/778) was adopted on 29 November 1957: see GATT, (BISD) (1958) Sixth Supplement, para 2, pp70-71. In the examination of the North American Free - trade Agreement by the Committee on Regional Trade Agreements, the representative of the European Communities said that according to Article XXIV:4, “it was permissible to form free - trade agreements or customs unions, provided Members did so in a way that did not harm others or undermined the broad, non-discriminatory architecture of the multilateral trading system”: see WT/REG4/M/2; 21 February 1997; para. 22, p6).

the agreement on individual countries. The difficulty in determining the relationship between paragraphs 4 and 5-9 is succinctly summarised by Professor Kenneth Dam:

“The relationship between paragraph 4 and paragraphs 5 through 9 is...a fertile source of controversy. If an agreement clearly complies with paragraph 4, is it automatically to be considered as meeting the standards of paragraphs 5 through 9? Or does paragraph 4 really contain only introductory language, and, in view of the word “accordingly”, are the substantive rules to be found in paragraphs 5 through 9? Perhaps there are two complementary or additive sets of standards—the “purpose” test of paragraph 4 and the form requirement of the following paragraphs. The number of ways in which paragraph 4 can be related to paragraphs 5 through 9 is limited only by the number and the ingenuity of lawyers involved in the interpretation of Article XXIV.”¹⁰⁵

In the examination of the Caribbean Free - Trade Agreement, notwithstanding the elimination of barriers to substantially all the trade between the parties, there was no consensus on whether the agreement satisfied the terms of Article XXIV:4. One member of the Working Party was of the view that the Agricultural Marketing Protocol, which had established a restrictive regime on imports from third countries of a number of specified products until intra-Caribbean surpluses of these items had been disposed of, was inconsistent with the Article, as it erected barriers to the trade of third countries. The import of this Member's objection was that in assessing whether the terms of the Article had been complied with, a disaggregated analysis should be used to determine the barriers which had been erected since the implementation of the regional trading arrangement.¹⁰⁶

Similarly in the examination of the Accession of Portugal and Spain to the European Communities, the view was expressed by some members of the Working Party that notwithstanding the significant reduction in the level of tariffs, the imposition of quantitative restrictions by the two countries on a number of products was contrary to Articles XI, XIII and XXIV:4. They, in effect, argued that for the terms of Article XXIV:4 to be complied with, it must be demonstrated that no barriers were erected against any product or group of products. The representative of the European Economic Community rejected this interpretation of Article XXIV:4 and said that the Article “did

¹⁰⁴GATT, Sixth Supplement, *ibid*, para. 3, p71.

¹⁰⁵Dam (1970) p278.

not constitute an obligation but an objective and did not preclude members of a customs union from erecting barriers to trade, if their overall incidence was less restrictive than the ones which had prevailed before the customs union was established".¹⁰⁷

In the examination of the Free - trade Agreement Between Canada and the United States, the representative of the United States implicitly accepted that for an agreement to be consistent with Article XXIV, it had to comply with both the terms of Article XXIV:4 and 5: "[i]n accordance with both paragraphs 4 and 5 of Article XXIV, the Canada-United States Free - trade Agreement had not raised barriers to third-country trade either directly in the context of the phased-in implementation of the provisions of the Agreement or indirectly as a consequence of its negotiation".¹⁰⁸ The view was expressed by some members of the Working Party that for an agreement to be consistent with the terms of Article XXIV, it has to create trading opportunities for third countries. The same view was expressed by some members of the Working Party in EEC-Association Agreements with African and Malagasy States and Overseas Countries and Territories.¹⁰⁹ They claimed that an agreement would be inconsistent with the terms of Article XXIV:4, if the parties to the agreement were at different levels of development and produced different products. To put it differently their argument was that trade diversion from third countries was more likely in such a scenario, as the parties were more likely to buy from each other in order to take advantage of tariff and other preferences. Should that occur, then third countries which used to export similar products to the two countries would lose market share, especially if the tariffs being maintained by the parties are high.¹¹⁰

¹⁰⁶The Working Party Report (L/3584) was adopted on 9 November 1971: see GATT, (BISD) (1972) Eighteenth Supplement, para. 8, p131.

¹⁰⁷The Working Party report (L6405) was adopted on 19-20 October 1988: see GATT, (BISD) (1989) Thirty-Fifth Supplement, para. 22, p306.

¹⁰⁸The Working Party report (L6927) was adopted on 12 November 1991: see GATT, Basic Instruments and Selected Documents (BISD) (1992) Thirty-Eighth Supplement, para. 76, p70.

¹⁰⁹The Working Party report (L2411) was adopted on 4 April 1966: see GATT, (BISD) (1966) Fourteenth Supplement, para. 13, p106. The representatives of the EEC and the Associated States disagreed with this interpretation. Their view was that "if the requirements of paragraphs 5 to 9 of Article XXIV were fulfilled, the Agreement was necessarily compatible with the principle set out in paragraph 4." *ibid* at para. 14, p106.

¹¹⁰In European Economic Community -- Agreements of Association with Tunisia and Morocco, a number of developing countries expressed doubts about the consistency of the agreements with Article XXIV:4: "Several delegations expressed concern that the agreements might be trade-diverting instead of trade-creating. Their countries had accepted Article XXIV as

During the Uruguay Round, negotiators had the opportunity to clarify the scope of this provision and its relationship with other provisions of Article XXIV, but failed to state in clear and unambiguous language what the obligations of Members are under the Article. Indeed, it could possibly be argued that the Understanding compounded the murky situation by providing that "[c]ustoms unions, free - trade areas, and interim agreements leading to the formation of a customs union or free - trade area, to be consistent with Article XXIV, must satisfy, *inter alia*, the provisions of paragraphs 5, 6, 7 and 8 of that Article." Proponents of a broader interpretation of the terms of Article XXIV:4 have seized upon the use of the words " must satisfy, *inter alia*, the provisions of paragraphs 5, 6, 7 and 8" to bolster their argument that in addition to the specified articles, there are other obligations which have to be satisfied by Members wishing to form customs unions or free - trade areas including those specified in Article XXIV:4.

While there is some merit to that argument, there is nothing in the terms of the Understanding which confirm that Article XXIV:4 lays down a separate and distinct obligation which has to be complied with by Members. If that was indeed the intention of Members, they could have expressly stated so. Indeed, in a recent case between India and Turkey, the panel held that Article XXIV:4 did not lay down a separate obligation in and of itself.¹¹¹ The fundamental issue in that case was whether Article XXIV of GATT 1994 obligated Members of the WTO which are parties to a regional trade arrangement (customs union) to have the same commercial policy towards third countries and, if it did, whether it justified the introduction of quantitative restrictions prohibited by GATT 1994 and the Agreement on Textiles and Clothing and Article XI of GATT 1994.

Turkey argued that Article XXIV:4 did not create a separate obligation which had to be complied with by Members wishing to form regional trade arrangements. It

an exception to Article I, but clearly on condition that Article XXIV was rigorously applied and that purely regional agreements were not permitted. Representatives of developing countries felt that their most essential export interests would be jeopardized because Tunisia and Morocco exported similar products as these countries themselves did to the Community, which was their most important market". The Working Party report (L3379) was adopted on 29 September 1970: see GATT, (BISD) (1972) Eighteenth Supplement, para. 9, p151.

¹¹¹*Turkey - Restrictions on Imports of Textile and Clothing Products*. The report of the Panel as modified by the Appellate Body, was adopted on 19 November 1999, WT/DS34/R, para 9.126 at p131.

submitted that the consistency of measures adopted by parties to a regional trading arrangement had "to be determined by reference to Article XXIV:5 to Article XXIV:8 of GATT and not to other GATT provisions."¹¹²

India argued that while Members of the WTO were free to enter into regional trade arrangements, they still had to respect other WTO disciplines. In other words, a Member is not exempted from its WTO obligations, simply because it has entered into a regional trade arrangement with another country be it a Member of the WTO or not. The guiding principle laid down in Article XXIV:4 had to be respected by all Members entering into regional trade arrangements, otherwise WTO rules would be abused and rendered ineffective:

"[I]f Turkey's argument were accepted, Members forming a customs union could legally circumvent the procedural and substantive requirements in respect of quotas, which the negotiators of the WTO agreements agreed to permit in exceptional circumstances, and would have every incentive to do so. In respect of such Members, the WTO agreements could no longer operate as a legal framework providing effective assurance of market access and the WTO dispute settlement procedures would be rendered ineffective. This would create a serious imbalance between the obligations of Members forming a customs union and other Members, and would upset the balance of concessions negotiated between them. The drafters of the GATT and the Uruguay Round agreements could not possibly have intended this result."¹¹³

India's argument was supported by several countries which had participated in the proceedings as third parties. The Philippines, for example, argued that the obligation in Article XXIV:4 was separate and distinct from the one imposed by Article XXIV:5:

"Members had established a standard, separate and distinct from the standard imposed under Article XXIV:5, for the implementation of the phrase "not to raise barriers to the trade of other contracting parties" in Article XXIV:4, since the preamble of the Understanding on Article XXIV provided, among others, that in the formation or enlargement of RTAs "the parties to them should to the greatest possible extent avoid creating adverse effects on the trade of other Members".¹¹⁴

¹¹²*Ibid* at para. 6.32 at p37.

¹¹³*Ibid* at para. 6.47 at p39.

¹¹⁴*Ibid* at para. 7.41 at p78.

The Panel was not swayed by these arguments as is evident from the following passage:

"[w]hile not expressed as an obligation, paragraph 4 (and its elaboration in the fifth paragraph of the Preamble of the GATT 1994 Understanding on Article XXIV) argues against an interpretation of paragraph 5(a) that would read into that paragraph an exception to GATT rules that prohibit specific trade barriers."¹¹⁵

This view of the Panel was endorsed on appeal by the Appellate Body:

"Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV. Thus, the purpose set forth in paragraph 4 informs the other relevant paragraphs of Article XXIV, including the chapeau of paragraph 5. For this reason, the chapeau of paragraph 5, and the conditions set forth therein for establishing the availability of a defence under Article XXIV, must be interpreted in the light of the purpose of customs unions set forth in paragraph 4. The chapeau cannot be interpreted correctly without constant reference to this purpose."¹¹⁶

Notwithstanding the views of the Panel and the Appellate Body, it cannot be taken as settled that Article XXIV:4 does not create a separate obligation which has to be respected by WTO Members wishing to form regional trading arrangements. Although the views of the Appellate Body are treated with respect by WTO Members, it is expressly stated in Article IX:2 of the Marrakesh Agreement Establishing the WTO that "[t]he Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements." Thus, the views of the Appellate Body are not binding on the entire membership of the WTO. Indeed, as is stated in Article 19.2 of the Dispute Settlement Understanding (DSU), "in their findings and recommendations, the panel and Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements."

¹¹⁵*Ibid* at para. 9.123 at p131.

¹¹⁶*Turkey - Restrictions on Imports of Textile and Clothing Products*. The Appellate Body report was adopted on 19 November 1999, WT/DS34/AB/R, para. 57 at p15.

Similarly, it is provided in Article 17.14 of the DSU that, "[a]n Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute." In other words, Members which were not parties to the dispute are not under any obligation to accept the report. It is well established under GATT/WTO law that the views of previous panels are not binding on subsequent panels. They are merely of persuasive effect and not required to be followed.

It is doubtful whether the ruling of the Appellate Body would influence Members to abandon the discussion currently taking place in the Committee on Regional Trade Agreements about the relationship between Article XXIV:4 and the Articles XXIV:5-9. The problem is that third parties have always looked to Article XXIV:4 for protection of their interests. Should they accept that it does not create any separate obligation to be respected by Members entering into regional trading arrangements, then they would have implicitly accepted the argument which has always been advanced by the European Communities that the operative language is contained in Article XXIV:5, under which a global assessment has to be undertaken to determine whether or not the general incidence of duties and other regulations of commerce has become more restrictive after the formation of the regional trading arrangement. It is for this reason that the issue is likely to remain among the systemic issues being considered by the Committee on Regional Trade Agreements.

Given the overarching objective to strengthen the multilateral trading system, the question arises whether the ruling of the Appellate Body should be regarded dispositive of the relationship between Article XXIV:4 and the rest of the provisions of Article XXIV. From the viewpoint of many third countries, the ruling of the Appellate Body may be disappointing, as it puts more emphasis on a global assessment instead of a disaggregated approach. While there is no question that the rights of third countries should be protected, it should also be recognised that there should be a balance between rights and obligations of Members wishing to form regional trade agreements.

From a realistic point of view, it is not possible to insist on the preservation of all the rights of third parties prior to the formation of the regional trading arrangement. Put in another way, it is to be expected that the formation of a customs union might

result in increased barriers for some products originating in third countries. Given that consideration, I think the ruling of the Appellate Body is sound and should be endorsed by the CRTA. Having made that recommendation and to ensure that the rights of third countries are protected to the maximum extent possible, it is recommended below that parties to regional trading arrangements (customs unions) should be obliged, at the very minimum, to apply the lowest tariff which was being applied by one of the constituent territories prior to the formation of the union. If the parties intend to form a free - trade area, there should be a requirement that the parties maintain, at least, the same level of their external tariffs prior to the formation of the free - trade area.

4.2.2 The Scope of Article XXIV: 5 of GATT

Article XXIV:5 is one of the most controversial provisions in GATT 1994. It has provoked much controversy and brought into focus the ability of the WTO to protect the rights of third parties and ensure that regional trading arrangements do not undermine multilateral efforts at trade liberalisation. The general intent of the drafters in inserting the subsection into the General Agreement is quite clear: it is simply to protect the interests of third countries and prevent Members from imposing unjustified restrictions on trade under the guise of forming customs unions and free - trade areas to liberalise trade between themselves.¹¹⁷ As noted in a communication from Australia:

“GATT Article XXIV:5 is concerned with the relationship of the parties to customs unions and free - trade areas with non-members. It is based on four assumptions. The first, an obvious one, is that there is a difference between free - trade areas and customs unions. Second, it assumes that each constituting party maintained a set of duties and other regulations of commerce before the customs union or free - trade area entered into force. Third, it accepts that the details of their incidence on third countries may be varied in the negotiations leading to the formation of the new arrangement. Fourth, it insists that on the whole, the duties and other regulations applied against non-parties must be no higher or more restrictive than they were before the arrangement was put in place”.¹¹⁸

¹¹⁷Dam (1970) p277.

¹¹⁸See WTO Document WT/REG/W/25; 1 April 1998

Two provisions of Article XXIV:5, namely Article XXIV:5(a) and Article XXIV:5(b), have particularly given rise to legal controversy.¹¹⁹ They have been debated upon and trenchantly criticised by academics and legal scholars and none of the over 100 Working Parties that were established under the GATT to examine the consistency of notified regional trade agreements with the rules of the WTO was able to lay down definitively the parameters of these Articles. As a result of this “legal” loophole, Members wishing to form customs unions and free - trade areas have been without guidance as to which conditions they should fulfil. Each Member has, therefore, interpreted these Articles in such a way as to suit its own particular circumstances.

Among the difficulties that have been encountered in connection with the interpretation of these provisions are the following: (i) the meaning of the phrase “as between the territories of contracting parties” in the chapeau of the Article; (ii) the meaning of the phrase “duties and other regulations of commerce imposed at the institution of any such union/maintained in each of the constituent territories; (iii) scope of the requirement relating to the obligation that duties and other regulations...”shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories; and (iv) the meaning of the following phrases: “interim agreement”, “reasonable period of time” and “plan and schedule”. These are taken in turn below.

4.2.2.1 *The meaning of the phrase “as between the territories of contracting parties”*

This phrase has not provoked great controversy between Members of the WTO, but it has raised difficulties in the past. Basically, it is not known whether the Article is applicable to customs unions or free-trade unions entered into by a Member of the WTO and a non-Member. A literal reading would seem to suggest that the Article was drafted with only Members in mind. That seems to have been the interpretation of the French delegation at the Havana Conference in 1948, when they asked for a waiver to enable

¹¹⁹The terms of these two Articles are identical. Whereas the provisions of paragraph (a) cover customs unions, the provisions of paragraph (b) cover free - trade areas. Where an issue is of relevance to only of the paragraphs, it is indicated.

them to implement a customs union agreement with Italy, which was not then a contracting party to the GATT:

“The representative of France explained that acceptance of the Protocol by his Government would be contingent upon the agreement of the contracting parties to waive one of the obligations so as to enable France to proceed with the formation of a customs union with Italy without first requiring Italy to accede to the General Agreement”.¹²⁰

The matter was not deemed settled in subsequent cases which were referred to Working Parties. In some of these cases, some members of the Working Parties argued for a strict interpretation of the chapeau of Article XXIV:5 to exclude agreements entered into between Members and non-Members. They insisted that such agreements should be handled under the provisions of Article XXIV:10 whose provisions were sufficiently wide to cover situations such as these.¹²¹ In EEC - Agreements of Association with Tunisia and Morocco, the issue divided members of the Working Party:

“With regard to the first sentence of paragraph 5, one delegation pointed out that the term ‘territories of contracting parties’ did not cover the agreements with Tunisia and Morocco, the former having only provisionally acceded while the latter had as yet no relation with GATT. Attention was drawn by this delegation to the Havana Reports on Article 44 of the Charter, and in particular to paragraph 6 which corresponds to paragraph 10 of Article XXIV. It was understood that this paragraph ‘will enable the Organization to approve the establishment of customs unions and free - trade areas which include non-members’. This interpretation has been confirmed by a decision in 1956 on the participation of Nicaragua in the Central American Free - trade area (BISD 5S/29). The representative of the parties to the agreements recalled that in other previous cases, notably in the cases of EFTA and LAFTA, some participants in those free - trade areas were not at that time contracting parties and some of them were still not. Accordingly, it had been shown in practice that the concept ‘territories of contracting parties’ had not been interpreted as restricting the applicability of paragraph 5”.¹²²

¹²⁰Quoted in WTO, Analytical Index (1994) p798.

¹²¹The Working Party Report (L/1235) was adopted on 4 June 1960: see GATT, Basic Instruments and Selected Documents (BISD) (1961) Ninth Supplement, para. 58 at p86. The Working Party Report (L/1364) was adopted on 18 November 1960: see GATT, Basic Instruments and Selected Documents (BISD) Ninth Supplement, para. 31 at p94.

¹²²The Working Party report (L3379) was adopted on 29 September 1970: see GATT, (BISD) (1972) Eighteen Supplement, para. 16 at p154.

While the above paragraph generally leaned in favour of a liberal interpretation of the provisions of Article XXIV regarding agreements entered into between contracting parties to the GATT and non-contracting parties, the issue resurfaced later in the context of the applicability of Article XXIV:7 to interim agreements concluded between the European Economic Community and a number of Mediterranean countries, several of which were not contracting parties to the GATT. The United States argued that the Article was not applicable to agreements entered into between contracting parties and third countries and that such agreements were subject to the procedures of Article XXIV:10 which required a two-thirds majority approval. While not expressly rejecting the contention of the United States in this matter, the Panel stated that this issue was not novel and a number of such agreements (between Members and non-Members) had been considered by other Panels under the provisions of Article XXIV:7(b).

As this panel report was not adopted, its value is limited. In any case, one of the systemic issues currently being considered by the Committee on Regional Trade Agreements is how to deal with regional trade agreements entered into between Members of the WTO and non-Members.¹²³ It is a difficult and complex issue as on the one hand, the WTO cannot compel non-Members to comply with its rules and regulations. But on the other hand, it has jurisdiction over its Members and can entertain any action brought by other Members in respect of the operation of that particular regional trade arrangement.

The issue has some practical significance, as it could eventually determine whether the WTO would have the authority to veto trade agreements entered into by its Members with third countries. If it should be decided that all such agreements should be handled according to the procedures laid down in Article XXIV:10, then a two-thirds majority vote would be required before agreements could be legally implemented. Whereas it might not be difficult for Members to muster two-thirds majority vote in the Committee on Regional Trade Agreements, especially where the agreement under consideration is not blatantly discriminatory, the danger is that given the practice of the WTO to adopt decisions by consensus, one Member which is adamantly opposed to the

¹²³See WTO Document WT/REGW/16; 26 May 1997.

agreement for whatever reason, may single-handedly be able to frustrate the whole process.

Should the vote even take place to decide on the consistency of an agreement, it might create more problems than it is intended to resolve, especially where unanimity is still required to judge the compatibility of agreements entered into by only Members of the WTO. The focus should be on the substantive rules and not on the signatories to the agreement. Should focus be placed on the latter, it is possible to envisage the situation where two identical agreements entered into by a Member with another Member and the other with a non-Member were treated differently. Such an occurrence would be hard to justify and could exacerbate trade tensions, which eventually could have a negative impact on the multilateral trading system.

4.2.2.2 The meaning of the phrase “duties and other regulations of commerce”

Whereas there has been very little argument about the term “duties”¹²⁴, the meaning of “other regulations of commerce” has been sturdily debated in the past without any clear result. Basically, opinions are divided as to whether certain trade policy instruments such as quantitative restrictions, rules of origin, variable levies, customs user fees and duty remission schemes could be described as “other regulations of commerce” within the meaning of Articles XXIV:5(a) and (b) or under and 8(a) (ii) of GATT 1994.¹²⁵

The issue is of much relevance because if the above instruments of trade policy are considered to be within the ambit of Article XXIV:5 (a) or (b), then account should be taken of them when calculating the general incidence of duties (or corresponding duties) and regulations of commerce after the formation of the customs union or free - trade area, as the case may be, to determine whether they have become higher or more

¹²⁴During the examination of the Accession of Greece and Spain to the European Communities, the issue arose as to whether variable levies could be properly said to constitute “duties and other regulations of commerce” within the meaning of Article XXIV: see WTO (1994) at p800.

¹²⁵WTO Document WT/REG/W/17/Add.1; 5 November 1997, p2.

restrictive. The inclusion or exclusion of some measures could have several ramifications as to upset the delicate balance of interests that Article XXIV seeks to uphold and protect. If a Member is applying a measure which is WTO-inconsistent, but insists that it comes within the purview of Article XXIV:5, that country may be able to get away with it and avoid compensating third countries which might have sustained some losses as a result of the application of those measures.

4.2.2.2.1 *Quantitative Restrictions*

One of the most divisive issues as far as Article XXIV:5 is concerned is whether the phrase “regulations of commerce” encompass quantitative restrictions. If it does, then the question is whether in calculating the general incidence of duties and other regulations of commerce, they should be included in the assessment. The view has been expressed that quantitative restrictions cannot be properly regarded as regulations of commerce and that since they are prohibited under Article XI of GATT 1994, except in a limited number of situations, parties to regional trade agreements should not be permitted to legalise a measure which is WTO-inconsistent. While Article XXIV:5 envisages the adoption of a number of trade measures, it is claimed that it does not anticipate the adoption of quantitative restrictions prohibited by the WTO Agreement.

In the examination of the Treaty of Rome, the members of the EEC disagreed with some members of the Working Party who had expressed the opinion that quantitative restrictions fell outside the scope of Article XXIV:5 and could not be lawfully imposed by parties to a regional trading arrangement:

“Most members of the Sub-Group could not accept the interpretation of the Six [members of the EEC] of paragraph 5(a). In their view the use of the term ‘regulations’ in this paragraph and in paragraph 8(a)(ii) does not include quantitative restrictions imposed for balance-of-payments reasons. An examination of the provisions of the Agreement indicates that the term ‘regulations’ is consistently used to describe such matters as customs procedures, grading and marketing requirements, and similar routine controls in international trade. This is reinforced by the fact that in 8(a)(i) the term ‘regulation’ is qualified by the word ‘restrictive’ in the one instance where Article XXIV specifically refers to balance-of-payments Articles. Moreover, the term ‘regulation’ does not appear in the balance-of-payments Articles of the General Agreement. The General Agreement prohibits the use of quantitative restrictions for protective purposes and permits their use only in exceptional

circumstances and mainly to deal with balance-of-payments difficulties. Accordingly the notion that paragraph 5(a) would require that temporary quantitative restrictions should be treated in the same way as normal protective measures such as tariffs in determining the trade relations between countries in a customs union and third countries would be contrary to the basic provisions of the Agreement which preclude the use of quantitative restrictions as an acceptable protective instrument".¹²⁶

To the same effect were the opinions of some members of the Working Party in the examination of the Accession of Portugal and Spain to the European Communities. There, some members of the Working Party argued that since the GATT had generally set its face against quantitative restrictions and prohibited their use, they could not be included in the assessment to determine whether the regulations of commerce being applied by the parties after the implementation of the regional trade agreement had become more or less restrictive. In other words, they argued that parties to regional trade agreements cannot claim credit for removing or relaxing quantitative import restrictions after the implementation of their agreement, neither could they demand that the imposition or tightening of quantitative restrictions should be offset by reductions made on other regulations of commerce:

“[t]he conditions stipulated in Article XXIV could not be presumed fulfilled simply because the customs union had resulted in some minor improvements in market access...GATT-inconsistent measures...could not be included in the assessment of the incidence of changes in “other regulations of commerce” which had to be carried out under Article XXIV:5(a)...Discriminatory quantitative restrictions ...contravened Articles XI, XIII and Article XXIV:4 [and] since Article XXIV did not provide a waiver from obligations contained in Articles XI and XIII and did not allow or require a country acceding to a customs union to adopt the more restrictive trade regime of the customs union, [the parties had]...to eliminate all GATT-inconsistent measures...Measures which were inconsistent with the GATT could not be traded off against the alleged reduction of other barriers and could not be included in the assessment of incidence of changes in “other regulations of commerce” required by Article XXIV:5(a) under which GATT-consistent measures should be taken into account”.¹²⁷

¹²⁶GATT, BISD, Sixth Supplement, *supra* note 103 at para. 5 at pp78-79.

¹²⁷GATT, BISD, Thirty-fifth Supplement, *supra* note 107, paras 38-39 at pp315-316. In response to these arguments, the representative of the EC argued that whereas “Article XXIV did not provide a waiver from other provisions of the GATT...the role of the Working Party in this

This is a difficult issue to resolve. On the one hand, there is nothing in Article XXIV:5 which would indicate clearly that quantitative restrictions cannot be regarded as regulations of commerce. If the drafters had intended them to be excluded from the ambit of Article XXIV:5, they could have expressly said so, especially considering that a significant number of countries frequently make use of quantitative restrictions as a trade measure to counteract balance-of-payments problems and to assist the development of “infant” industries. On the other hand, the argument advanced by the critics of EEC's position on this issue makes sense, because the WTO Agreement would be significantly weakened if, through the formation of customs unions or free - trade areas, Members were able to impose measures which were generally prohibited by the Agreement.

Although this has been one of the most vexing issues as far as the interpretation of Article XXIV is concerned, the Understanding on the Interpretation of Article XXIV failed to clarify the scope of the Article. Thus, it is still not clear whether quantitative restrictions could be regarded as regulations of commerce within the meaning of Article XXIV:5. It is one of the systemic issues currently being considered by the Committee on Regional Trade Agreements.¹²⁸

The issue resurfaced in the dispute between Turkey and India over the former's imposition of quantitative restrictions on the latter's exports of textile and clothing products following the implementation of a customs union agreement with the European Union. Turkey argued that there was nothing in Article XXIV:5 which prevented Members of the WTO forming regional trade arrangements from introducing quantitative restrictions. It argued forcefully that if India's claim were to be accepted, it would render the provisions of Article XXIV:5 meaningless:

"[It was Turkey's view that the]...plain meaning of Articles XXIV:4 and 5] was clearly that the provisions of GATT did not prevent the imposition of a regulation of commerce at the institution of a customs union, as long as on the

context was to examine the situation in the light of Article XXIV rather than with respect to any other provision such as Articles XI or XIII": *ibid*, para. 45 at p318.

¹²⁸WTO, *supra* note 125.

whole this was not more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of the customs union. If, as argued by India, Article XXIV:5(a) did not allow Members forming a customs union to introduce a common regulation of commerce determined by restrictive measures lawfully applied by a member party to that customs union, the plain wording of Article XXIV:5(a) would be deprived of any meaning. As had been made clear by the Appellate Body, an interpretation might not result in reducing whole clauses or paragraphs to redundancy or inutility."¹²⁹

In support of its argument, Turkey sought to rely on the provisions of paragraph 2 of the GATT 1994 Understanding on the Interpretation of Article XXIV, which relevantly provides that "for the purposes of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required."

India challenged the validity of the Turkish arguments and insisted that Article XXIV, by its very terms, did not sanction the introduction of quantitative restrictions, measures which are expressly prohibited by Article XI of GATT 1994:

"[T]he terms of Article XXIV:5 do not provide a legal basis for measures otherwise incompatible with GATT/WTO rules. This provision merely authorizes the formation of a customs union or free - trade area, nothing else. Its terms consequently exempt from the other obligations under the GATT only measures inherent in the formation of a customs union or a free - trade area. For instance, a customs union or a free - trade area could only be formed by the granting of regional treatment inconsistent with Article I and Article XXIV clearly provides a justification therefor. *However, customs unions and free - trade areas could be formed without the introduction of new quantitative restrictions on imports from third countries inconsistent with Article XI of GATT. There is, in particular, nothing that requires Members forming a customs union to impose new restrictions on imports from one particular third Member, inconsistently with Articles XI and XIII of GATT and Article 2.4 of the ATC.*"¹³⁰ (italics added).

After reviewing the arguments of the parties, the Panel concluded that quantitative restrictions could be properly regarded as "regulations of commerce" within the meaning of Article XXIV:5:

¹²⁹ *Supra* note 111, para. 6.33 at p37. See further paras 9.109-9.112 at pp127-128.

¹³⁰ *Ibid*, para. 9.113 at p128.

"While there is no agreed definition between Members as to the scope of this concept of "other regulations of commerce", for our purposes, it is clear that this concept includes quantitative restrictions... Given the dynamic nature of regional trade agreements, we consider that this is an evolving concept... We note that the language of paragraph 5(a) of Article XXIV is general and not prescriptive. While it authorizes the formation of customs unions, it does not contain any provision that either authorizes or prohibits, on the occasion of the formation of a customs union, the adoption of import restrictions otherwise GATT/WTO incompatible, by any of the parties forming this customs union... While the wording of paragraph 5(a) assumes that, as a result of a customs union, some (applied) duties may be higher, and/or other regulations of commerce may be more restrictive than before, it does not specify whether such a situation may occur only through GATT/WTO inconsistent actions. What paragraph 5(a) provides, in short, is that the effects of the resulting trade measures and policies of the new regional agreement shall not be more trade restrictive, overall, than were the constituent countries' previous trade policies."¹³¹

The Panel is right, in my view, in asserting that a literal interpretation of the phrase "other regulations of commerce" would seem to include quantitative restrictions. But the real issue is whether the drafters envisaged the introduction of measures that are generally prohibited by the WTO Agreement. The panel accepted the argument of India that the fact that quantitative restrictions may qualify as a regulation of commerce does not necessarily mean that parties to a regional trading arrangement could impose them upon the implementation of their agreement:

"we consider that the wording of Article XXIV does not authorize a departure from the obligations contained in Articles XI and XIII of GATT and Article 2.4 of the ATC... [P]aragraphs 5 and 8 of Article XXIV provide parameters for the establishment and assessment of a customs union... These provisions do not, however, address any specific measures that may or may not be adopted on the formation of a customs union and importantly they do not authorise violations of Articles XI and XIII, and Article 2.4 of the ATC. Moreover, we note that paragraph 6 of Article XXIV provides for a specific procedure for the renegotiation of tariffs which are increased above their bindings upon formation of a customs union; no such provision exists for quantitative restrictions. To the Panel, if the introduction of WTO inconsistent quantitative restrictions were intended to be negotiable on the formation of a customs union, it would seem odd to us that an explicit procedure would exist for changes in GATT's preferred form of trade barrier (i.e. tariffs), while no procedure would be provided for

¹³¹*ibid*, para. 9.120 at pp129-130.

negotiation of compensation connected with imposition of otherwise GATT inconsistent measures." ¹³²

The security and predictability of the multilateral trading system would be severely compromised if Members of the WTO could circumvent their obligations by simply entering into regional trading arrangements. As was forcefully argued by Thailand, if Turkey's argument were to be accepted, Article XXIV would *de facto* become an exception not only to Article I, but also Articles XI and XIII of GATT 1994. Such a situation could never have been contemplated by the Members of the WTO. In fact, it is well established in WTO jurisprudence that a waiver from the prohibition in Article I does not automatically extend to Articles XI and XIII. In *Bananas III*, the Appellate Body underlined this fact by finding that the waiver granted to the European Communities and the ACP countries from the non-discrimination principle in Article I did not extend to other Articles of the GATT 1994, particularly Articles XI and XIII. ¹³³

On appeal, the Appellate Body adopted a different approach. It held that parties to a regional trading arrangement could introduce WTO-inconsistent measures provided they could justify that without the imposition of those measures it would not be possible to establish the trading arrangement:

"[W]e are of the view that Article XXIV may justify a measure which is inconsistent with certain other GATT provisions. However, in a case involving the formation of a customs union, this "defence" is available only when two conditions are fulfilled. First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of the customs union that fully meets the requirements of sub-paragraph 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of the customs union would be prevented if it were not allowed to introduce the measure at issue." ¹³⁴

While the approach adopted by the Appellate Body is to be welcomed to the extent that it would act as an effective check on Members which may want to circumvent their obligations under other GATT Articles, it also raises the issue whether

¹³² *ibid*, paras 9.188-9.189 at p146.

¹³³ *European Communities - Regime for the Importation, Sale and Distribution of Bananas* WT/DS/26/R. The Panel report as modified by the Appellate Body report were adopted on 25 September 1997.

¹³⁴ *Turkey - Restrictions on Imports of Textiles and Clothing Products*, *supra* note 111, para. 58 at p16.

it is the task of panels to assess the overall compatibility of regional trade agreements with the multilateral trade rules. Until quite recently, it was fairly established in GATT jurisprudence that panels could not do that and that it was only the political organs of the GATT/WTO which could exercise that power.¹³⁵

Given the fact it has long been disputed whether quantitative restrictions qualify as regulations of commerce within the meaning of Article XXIV:5 of the GATT 1994, it would be extremely helpful if the CRTA could formally take note of the views of the Panel and Appellate Body on this issue. As was stressed by the Panel, the fact that they constitute regulations of commerce does not necessarily mean that they can be imposed at will. This point was underscored by the Appellate Body when it stated that their introduction can only be justified if it can be proved that without their introduction, it would be difficult for the parties to the regional trade agreement to achieve their objective of either establishing a free - trade area or a customs union.

4.2.2.2.2 *Rules of Origin*

As previously noted, parties to free - trade areas usually adopt stringent rules of origin to prevent products originating in third countries from entering their markets duty-free or at concessionary rates. Three types of rules of origin are usually adopted by parties to free - trade agreements. These are the "substantial transformation process" rule, which requires the imported product to undergo further processing so as to result in a change of tariff classification heading within the region. The second type may require that non-regional inputs account for no more than some specified maximum percentage of production cost or the transaction value of the product under consideration, while the third type may require some specific processes to be undertaken within the free - trade area or that some other product-specific technological requirement be satisfied.¹³⁶

Depending on the type of rules of origin which is chosen and the threshold figures or requirements set by the parties to the free - trade area, the rules could have the potential of raising or increasing barriers to external trade.¹³⁷ In a communication to the

¹³⁵Roessler (2000).

¹³⁶Serra et al. (1997) p13.

¹³⁷See generally Palmeter (1993a) (1993b).

Committee on Regional Trade Agreements, Japan gave two examples of how "a change in the rules of origin as a result of an enlargement of an RTA could have a restrictive effect on trade with a third country."¹³⁸

In the context of Article XXIV:5(b), the view has been expressed that given the potential impact of these rules, they should be regarded as coming within the definition of "other regulations of commerce". This view was articulated forcefully by one member of the Working Party in the examination of the European Communities — Agreements with Austria:

"the Agreement was contrary to the General Agreement because the rules of origin would frustrate the purpose of a free - trade area as stated in Article XXIV:4 in that they would frustrate intra-trade in products that could not meet the origin criteria and raise barriers to third-country trade in intermediate products; the requirements of Article XXIV:8(b) for elimination of restrictions on substantially all the trade had not been met because of [*inter alia*], the effects of the rules of origin; the requirement of Article XXIV:5(b) that external restrictions shall not be higher than in the constituent territories had not been met because of the rules of origin were so complex and cumbersome as to be a barrier to trade in and of themselves; in the absence of compelling reasons to the contrary, manufacturers within the free - trade area would favour origin sources over outside countries merely to be sure of qualifying under the rules of origin. Once trade shifts of that kind took place, the damage to third countries' exports would be difficult to remedy."¹³⁹

¹³⁸WTO Document WT/REG/W/28; 28 July 1998. "(i)...Consider a case where Countries A and B were members of an RTA. The RTA had regional rules of origin, under which, if a company located in A produced products with 50 per cent local content in the region (A and/or B), the origin of the RTA was granted to the products and the products were traded free of customs duties within the region. When Country C joined the RTA, however, new rules of origin were adopted. The new rules raised the local content ratio from 50 per cent to 60 per cent. A foreign country company (X) located in A had been using 50 per cent of contents from A and/or B, and had been exporting its products to B without custom duties. Under the new rules of origin, however, the foreign company (X) in A would have to use 60 per cent of contents from the region and reduce imports of contents from home Country X to a 40 per cent level in order to meet the new rules of origin. In addition to the negative effects on the imports of contents from X, the company (X) would have to bear the extra cost of technical adjustment so that its factory can incorporate the local and foreign contents at a ratio of 60 to 40. These rules can be considered more trade restrictive to third parties...

(ii) Countries C and D are members of an RTA which previously had rules of origin whereby if product P (material or component of a product Q) were imported from third country X to the region (C or D) and then converted or assembled to product Q, Q would have been given origin of either Country C or D. Countries C and D changed the rules of origin when Country E, which produces and exports product P to C and D, joined the RTA. New rules of origin no longer give origin to product Q converted in the region (i.e., C, D, E) from product P imported from third country X. As a result, manufacturers who manufacture product Q in the region from product P imported from X have to change the country from which the manufacturers import product P, from Country X to Country E in order to meet the new rules of origin."

While it is true that stringent rules of origin could cause "additional trade in intermediate goods to be diverted beyond what would result solely from differential tariffs applied to regional and non-regional sources of goods,"¹⁴⁰ parties to the regional trading arrangements have often argued that rules of origin do not come within the purview of the Article XXIV.5(b) and that even if they do, there is no uniform standard to assess their restrictiveness or otherwise under Article XXIV. In response to the view expressed above by the member of the Working Party, the EEC argued that:

"the rules of origin [in the agreement] were not intended to be trade diverting nor were likely to be in effect, but were aimed at preventing undesirable trade deflections under the free - trade arrangement...The rules that had been adopted were based on the objective principle of substantial processing and were designed to ensure that only goods meeting this principle could be considered as originating in the area...*the General Agreement offered no objective measure for evaluating rules of origin...[Members] were accordingly free, within the framework of Article XXIV and consistent with the objective of establishing a free - trade area, to adopt systems which met their needs and those of third countries.*"¹⁴¹ (italics added)

In the examination of the Agreement between the European Communities and Algeria, the view was expressed that restrictive rules of origin were inconsistent with Article XXIV:5(b), as they would restrict the trade of countries which were not signatories to the agreement under consideration:

"The stringent rules of origin provided for in the Agreement would result in components being largely sourced in the EEC, even if that were more expensive for the Algerian manufactures. [Rules of origin] had to be reasonable with regard to the percentage of third-country content...[I]f substantial processing in Algeria were the only guarantee of real development,...why [had] an exception been granted for components produced in the EEC."¹⁴²

¹³⁹The Working Party report (L3900) was adopted on 19 October 1973: see GATT, (BISD) (1974) Twentieth Supplement, para 5,p147.

¹⁴⁰Serra et al. (1997).

¹⁴¹*Supra note 139*, paras 27-28 at pp154-155. See further Agreement between the European Communities and Israel, where the parties to the agreement argued that they had the right to impose rules of origin by virtue of the provisions of Article XXIV:8 "which reserved the benefit of free - trade to products originating in the area; the provisions of Article XXIV:5(b) were not relevant in that respect because the tariff and trade regulations vis-à-vis third countries were not modified under the Agreement": The Working Party report (L4365) was adopted on 15 July 1976: see GATT, (1977) Twenty-third Supplement, para 10 at sp60.

In responding to the view that the rules of origin were unnecessarily complex and designed to restrict the trade of third countries, the EEC argued that the rules were not overly restrictive and that they had a choice as to how to fashion them:

"[The] rules of origin were clearly needed in order to ensure that the parties had the benefit of the tariff and quota dismantlement accruing under the Agreement which had the effect of reducing protection within the EEC...[T]he rules in question [were not] particularly strict; those rules were the result of a choice between the concern to foster Algeria's economic development and the need to avoid any evasion of the EEC customs tariff...While the General Agreement provided for rules of origin, it did not define any criteria in regard to them; like the needs of the parties, they could differ according to the case, consistently with the economic and commercial requirements of each context."¹⁴³

The Working Party established to examine the Free - trade Agreement between the EFTA countries and Spain was also unable to arrive at a unanimous result. While third parties expressed the view that the Agreement was inconsistent with Article XXIV, as it had the potential of raising barriers to internal and external trade, the EFTA countries argued that they had the right to enact rules which would further the realisation of their objectives under the Agreement. They stated that there "were no objective criteria available in the GATT to evaluate rules of origin and their effects on trade but if problems arose, the parties to the Agreement were ready to take into account any detailed evidence of export losses by third-country traders and would consider carefully any observations about possible damaging effects of these rules."¹⁴⁴

The issue again was considered by the Working Party in the examination of the Free - trade Agreement between Canada and the United States. The parties conceded that the purpose of rules of origin was solely to determine whether a product was eligible to benefit from preferential treatment under the agreement. Some members of the Working Party thought that the objective of the rules went far beyond achieving its declared purpose. They were of the view that the rules were too restrictive and had the

¹⁴²The Working Party report (L4559) was adopted on 11 November 1977: see GATT, Basic Instruments and Selected Documents (BISD) (1978) Twenty-fourth Supplement, para 17 at p86.

¹⁴³*Ibid* at para 19 at p86.

¹⁴⁴The Working Party report (L5045) was adopted on 10 November 1980: see GATT, (BISD) (1981) Twenty-seventh Supplement, para 26 at pp134-135.

potential of restricting the trade of third countries in certain sectors, and as such could be considered to be incompatible with the terms of Article XXIV:5(b). Responding to this view, the representative of Canada denied that the rules were too restrictive and that in any case, "the question of whether rules of origin were one of the "other regulations of commerce" in terms of Article XXIV:5(b) had not led to a solution in previous working parties on free - trade agreements."¹⁴⁵

The issue has still not been resolved and it is one of the systemic issues being considered by the WTO Committee on Regional Trade Agreements.¹⁴⁶ Given the importance of the issue and the real risk of rules of origin being abused by parties to regional trade agreements, it is important for the CRTA to clarify forthwith that rules of origin constitute "regulations of commerce" within the meaning of Article XXIV:5 of the GATT 1994 and also as "restrictive regulations of commerce" within the meaning of Article XXIV:8 of the GATT 1994. This would dispel the view that rules of origin are not to be taken into account in the assessment required under Article XXIV:5 to determine whether the general incidence of tariffs and regulations of commerce has become more restrictive after the formation of the free - trade area or the customs union.

The next step which the CRTA should consider is to adopt binding disciplines on preferential rules of origin. Currently, the WTO work programme only covers non-preferential rules of origin. The work on the harmonisation of non-preferential rules of origin was supposed to have been completed by 1 January 1998,¹⁴⁷ but deadlines upon deadlines have been set and missed. Members have agreed to complete the work by the November 2001, when the Fourth WTO Ministerial Conference will be held.¹⁴⁸

Given the fact that more than half of world trade is being conducted on a preferential basis, it is imperative for the WTO to move quickly to adopt appropriate

¹⁴⁵GATT, (BISD), Thirty-eighth Supplement, *supra* note 108, para. 37 at p59.

¹⁴⁶See WTO Document, WT/REG/W/17/Add.1, *supra* note 125. See further Communication from Australia in WTO Document WT/REG/W/25, *supra* note 118.

¹⁴⁷See Article 9.2(a) of the WTO Agreement on Rules of Origin.

¹⁴⁸Paragraph 5 of the General Council Decision of 15 December 2000 on Implementation-Related Issues and Concerns: It provides that "Members undertake to expedite the remaining work on the harmonization of non-preferential rules of origin, so as to complete it by the Fourth Ministerial Conference, or by the end of 2001 at the latest".

disciplines on rules of origin, otherwise they could easily be abused to divert trade from third countries as has been demonstrated by Japan in its communication to the WTO.¹⁴⁹

The critical question to be answered is: what constitutes reasonable rules of origin? From a multilateral perspective, it would be rules which are less distorting in the sense of having very little impact on the trade of third countries. Sam Laird suggests a number of options which could be adopted, if a decision is made to harmonise preferential rules of origin by the WTO:

"It would be useful to have a clearer set of preferential [rules of origin]...The option might be to agree on a single, simple standard such as the change of a heading criterion, that is, whether the transformation of the product would lead to it being reclassified under another four-digit-level item. Another possibility would be to agree on a fixed percentage of value added, say 60 per cent. However, this requires some degree of proof of national and foreign content. Moving further in the same direction, another, more sophisticated option, would be to change the basis of the customs valuation to value-added tariffs, such as is done in some offshore-processing arrangements. Under such a system, the appropriate level of duty would be applied to each share of value added by different partners."¹⁵⁰

However, given the difficulties which have been experienced with the harmonisation of non-preferential rules of origin, it would be a while before the WTO attempts to negotiate binding disciplines in this highly controversial area. In the interim, the WTO could consider a number of options. First, it could encourage parties to free-trade areas to avoid tariff dispersion and the adoption of widely differing regulations of commerce. In other words, while they are under no obligation to harmonise their external commercial policy, an effort should be made to narrow the differences in tariffs and regulations of commerce being applied by them. Where there are no significant differences in these trade policy instruments, the need for stringent rules of origin become unnecessary as in customs unions.

¹⁴⁹*Supra* note 138 and accompanying text. See further the following example given by Serra et al., to demonstrate how rules of origin could divert trade from third parties: "[Let us] consider, for example, an intermediate good with a MFN tariff of zero. Regional producers would have no reason to source this good from high-cost producers in partner countries in order to avoid payment of the MFN duty. But these producers might nonetheless prefer to import higher-cost regional components rather than lower-cost non-regional components in order to satisfy the rules of origin: That is, the use of regional inputs might make the final good eligible for preferential treatment within the region, when it would not otherwise be so...": *supra* note 89 at para. 24 at p13.

¹⁵⁰Laird (1999) p1184.

Given the fact that almost all WTO Members are parties to regional trade agreements, the WTO could consider insisting on the parties adopting the least restrictive rules of origin being applied by any of the parties under another free - trade agreement. Serra et al., make a similar suggestion; they recommend that the WTO insist on rules of origin not being "more restrictive than the *status-quo ante* regional content of exports".¹⁵¹ In other words, their proposal would require a calculation of the average share of regional value added in the total value of goods traded before the formation of the free-trade area.¹⁵²

4.2.2.2.3 *Variable Levies*

A variable levy is an import surcharge imposed by a country to shield its producers from price fluctuations. It is administered in such a way that the price of a product on the domestic market remains unchanged irrespective of price variations in exporting countries. Typically, if the world market price of a product should decrease, the rate of the variable levy would be increased so as to maintain domestic prices, which otherwise would have followed the trend. It was a common feature of the Common Agricultural Policy of the European Union until the entry into force of the WTO Agreement on Agriculture concluded during the Uruguay Round.

During the examination by the Working Party on the Accession of Greece to the European Communities, Australia requested an opinion on whether or not variable levies could be considered as a 'regulation of commerce', thus coming within the ambit of Article XXIV:5(a). One member of the Working Party expressed the view that since the imposition of variable levies would inevitably make the prices of foreign

¹⁵¹Serra et al. (1997) p46.

¹⁵²*Ibid* at para. 25 at p14. See also the suggestion by Hong Kong in (WT/REG/W/27) that preferential rules of origin should be tied to the definition of "substantially all the trade" appearing in Article XXIV:8. According to this proposal, in measuring substantially all the trade as percentage, the base (100 per cent of trade between the RTA parties) should comprise all intra -RTA trade measured according to MFN rules, while the qualifying proportion of trade (to meet the substantiality test) should be measured according to preferential rules of origin. Thus, the less stringent the preferential rules of origin, the higher percentage of members' intra-trade would be included towards meeting the substantiality test: quoted in Crawford and Laird (2000) p11.

agricultural products uncompetitive. the agreement between the parties was in breach of Article XXIV:5(b):

"In the agricultural sector which represented about 20 per cent of Greek imports, the amount of levies averaged 70-80 per cent...Greece prior to accession did not protect its agriculture very much because it produced several products while relying on imports for others. Since the accession, the import burden for the agricultural imports had risen 6-8 times. In addition, variable levies had, because of their frequently changing size, a dissuasive effect on exports from third countries...the view that third countries were not affected by the accession and that the Act was in conformity with the provisions of Article XXIV [was unacceptable]."¹⁵³

The EEC in a communication dated 10 March 1981 replied that "duties and other regulations of commerce" in the agricultural sector were unquestionably relevant to any examination of an agreement under Article XXIV:5(a), and ...[that] no contracting party could hold a contrary view. ...[V]ariable levies are covered by the phrase 'duties and other regulations of commerce'.¹⁵⁴ However, the EEC insisted that their agreement was not in breach of the provisions of Article XXIV.

The acceptance by the EEC that variable levies constituted a 'regulation of commerce' coming within the ambit of XXIV:5 was welcomed by one member of the Working Party, who noted that for sometime, the EEC had strenuously argued that they fell outside the scope of the Article: "This was a reversal of a position which the EEC had held since the introduction of their variable levy system and was one of the main issues which prevented progress being made in the previous Working Parties on the Rome Treaty and the 1972-73 enlargement."¹⁵⁵

4.2.2.2.4 *Customs User Fees*

Customs users fees are imposed by governmental authorities in connection with importation and exportation and are distinct from export or import duties. In the Free - trade Agreement between Canada and the United States¹⁵⁶, the latter exempted Canada

¹⁵³The Working Party report (L5453) was adopted on 9 March 1983: see GATT, (BISD) (1984) Thirtieth Supplement, para. 48 at p185.

¹⁵⁴*ibid* at para 37 at p181.

¹⁵⁵*ibid* at para 53 at p187

¹⁵⁶GATT, BISD, Thirty-eighth Supplement, *supra* note 108 at p47.

from the payment of these fees. This was challenged by some members as being contrary to Article I of the GATT 1994, which mandates Members to give all advantages and privileges extended to a Member of the WTO unconditionally to other Members of the WTO. The view was advanced that while it may be contrary to the provisions of Article I, it could probably be justified under Article XXIV.¹⁵⁷

In response to a question from a member of the Working Party as to which provision under Article XXIV would justify the granting of the waiver to Canada, the representative of the United States stated that the customs user fee was an "other regulation of commerce" covered under Article XXIV:5(b). The same member stated that Article XXIV:5(b) did not stipulate that a party to a free - trade area could waive the application of "other regulations of commerce", such as a customs user fee, with respect to other parties of the free - trade area. It was suggested by another member of the Working Party that customs user fees could be appropriately described as "other restrictive regulations of commerce" in the sense of Article XXIV:8(b). The suggestion was rejected by the representative of the United States, who argued that it appropriately fell within the scope of Article XXIV:5.¹⁵⁸

4.2.2.2.5 Duty Remission Schemes

In the Canada - United States Free - trade Agreement, the view was expressed that while the suppression of export-based waivers of customs duties under Article 1005 of the Agreement might not have affected any consolidated GATT rights, it had the effect of distorting trade patterns. Moreover, it established a situation that was more restrictive than that which prevailed prior to the entry into force of the Agreement.

The representative of Canada in response stated that the objective of not raising barriers to the trade of third countries as stipulated in Article XXIV:4 should be read together with the requirements of Article XXIV:5(b). That any judgment on the restrictive effect of eliminating the export-based duty remission scheme compared to the situation prevailing prior to the formation of the free - trade area, should be made with respect to trade in goods with bound tariff rates. The suggested use of bound rates as a

¹⁵⁷ *ibid* at para. 40 at p59.

¹⁵⁸ *Ibid* at p.60

benchmark was opposed by some members of the Working Party, who noted that "if the duty remission scheme had been terminated as part of the establishment of the free - trade area...another "regulation of commerce" had become more restrictive."¹⁵⁹

4.2.2.3 Scope of the Requirement Relating to the Obligation that Duties and other Regulations of Commerce "shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce" applicable in the constituent territories¹⁶⁰

At the heart of the dispute surrounding Article XXIV:5(a) and (b) is how to calculate the general incidence of duties and other regulations of commerce and make the determination whether they are not "on the whole higher or more restrictive". It is not precisely clear whether the subsection requires an aggregated or disaggregated analysis to be undertaken. The use of the phrases "on the whole" and "general incidence" is usually seized upon by parties to agreements establishing free - trade areas or customs unions as evidence that a global approach as opposed to a country-by-country or product-by-product analysis is the test that should be used in calculating the incidence or restrictiveness of tariffs or other regulations of commerce imposed by the regional trading bloc.

Most third countries disagree with the approach advocated by parties to regional trade agreements and argue in favour of a disaggregated approach. They insist that the paragraph requires separate analysis to be undertaken for tariffs and regulations of

¹⁵⁹*Ibid* at para. 62 at p66.

¹⁶⁰It should be noted that the language in Article XXIV:5(b) is slightly different. It relevantly provides that "the duties and other regulations of commerce maintained...shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free - trade area."

commerce. In other words, it is not appropriate to lump the two together when determining whether or not the trading regime of the constituent parties to the regional trade agreement has become more restrictive. As observed by the WTO Secretariat:

"One issue which has attracted attention refers to the assessment of the effects of duties and ORCs - is there a single, broad requirement for duties and ORCs grouped together or do duties and ORCs have to comply individually with the requirement?...Some Members maintain that these are two separate requirements, with compliance required for each. For them, a key word is the "or" in the phrase "shall not on the whole be higher or more restrictive...", where duties could not be "higher" and ORCs could not become "more restrictive".¹⁶¹ Further, in addressing the evaluation under Article XXIV:5(a), the 1994 Understanding refers to two overall assessments - i.e. that of tariffs, and that of ORCs which are difficult to quantify and aggregate.¹⁶² Other Members argue that the appearance of the words "on the whole" in Article XXIV:5(a) indicates that there is only one assessment, with tariffs and ORCs being lumped together; implying that certain benefits involved in one particular element might offset certain deficiencies in the other.¹⁶³ That interpretation has been questioned on the grounds that Article XXIV:5(b), which refers to FTAs, does not contain the term "on the whole"¹⁶⁴.¹⁶⁵ (emphasis in original)

Apart from this issue of whether or not tariffs and other regulations of commerce should be lumped together, there is some disagreement as to whether when considering only tariffs or other regulations of commerce, an aggregated analysis or disaggregated analysis should be used in calculating the restrictiveness or otherwise of tariffs or other regulations of commerce. Professor Dam has noted some of the difficulties:

"A principal decision to be made is whether the words "on the whole" and "general incidence" refer to each item in the common external tariff schedule or the common external tariff schedule as a whole. If the latter alternative is chosen, one must still determine whether the initial step is to calculate the height and restrictiveness of each national tariff schedule and then strike some kind of average between these national levels...Or is one first to strike some union-wide average for each tariff classification and then to determine the aggregate height of a common external tariff composed of these union-wide averages, the customs union being free to assign any duties on individual items in the common external tariff as long as the calculated union index is not exceeded? Whichever

¹⁶¹ See comments of Hong Kong, China in WT/REG/M/15; 13 January 1998, para. 22 at pp7-8; and comments of Japan in WT/REG/M/16; 18 March 1998, para. 59 at p15.

¹⁶² See comments of Hong Kong, China in WT/REG/M/16; *ibid* at para. 57 at p15.

¹⁶³ See comments of the EC, WT/REG/M/16; *ibid* at para. 63 at p17.

¹⁶⁴ *Supra* note 162

¹⁶⁵ WTO Secretariat (2000a) para. 64 at p27.

alternative is chosen, the unfortunate fact is that one cannot determine from nominal percentage rates the restrictive duty impact a duty may have. A relatively high duty may provide excess protection in the sense that it may be higher than necessary to eliminate all trade in the commodity in question. When one attempts to reach a judgment as to the overall restrictiveness of a schedule of duties, the assigning of weights to individual duties raises troublesome problems because the most convenient criterion for assigning weights—the respective volume of trade for each item—tends to be a function of, rather than independent of, the restrictiveness of the duty...¹⁶⁶

To fully appreciate the divergent views that have been expressed in relation to this sub - section, it would be helpful to consider the negotiating history and the subsequent interpretation which has been given to the various phrases used in the sub - section by WTO Members.

4.2.2.3.1 *"On the Whole"*

During the London session of the Preparatory Committee that was considering a draft of the General Agreement, it was stated in response to a question as to whether the new tariff rate on each product had to be below the average of the rates of the constituent territories prior to the formation of the union, that "the phrase 'on the whole'...did not mean that an average tariff should be laid down in respect of each individual product, *but merely that the whole level of tariffs of a customs union should not be higher than the average overall level of the former constituent territories*".¹⁶⁷ (italics added)

While the negotiating history seems to be quite clear in its choice of the test to be applied in evaluating the matters referred to in Article XXIV:5(a), third countries have insisted on the use of a disaggregated analysis, as they believe that it is more likely to protect their trade interests than a global approach.

4.2.2.3.2 *Meaning of general incidence of duties and other regulations of commerce*

A previous text of the General Agreement used the phrase "the average level" instead of the phrase "the general incidence", which in some respects was less

¹⁶⁶Dam (1970) p277.

ambivalent.¹⁶⁸ The reason for the change is contained in a report of a sub-Committee that considered the Geneva Draft Charter: "It was the intention of the sub-Committee that this phrase should not require a mathematical average of customs duties but should permit greater flexibility so that volume of trade may be taken into account."¹⁶⁹

In one of the first cases where the scope of Article XXIV:5(a) was considered, the majority of the members of the sub-Group expressed the view that it was not appropriate to have an automatic formula which could be applied in all cases. They stressed the necessity of examining notified agreements on a case-by-case basis taking into consideration a number of relevant factors including the volume of trade:

"...[M]ost of the members of the Sub-Group felt that an automatic application of a formula, whether arithmetic average or otherwise, could not be accepted, and agreed that the matter should be approached by examining individual commodities on a country by country basis. Attention was also drawn to the drafting history of paragraph 5(a) of Article XXIV, according to which the term 'general incidence of the duties' was used with the intention 'that this phrase should not require a mathematical average of customs duties but should permit greater flexibility so that the volume of trade may be taken into account'.¹⁷⁰

In response, the member states of the EEC insisted that since there was no prescribed method for calculating or evaluating the general incidence of duties and other regulations of commerce, they were free to adopt any method provided they satisfy the overarching objective of the Article:

"The representatives of the Member States drew attention to the fact that the provisions of Article XXIV do not exclude any method of calculation for the preparation of a common tariff, provided however that the duty rates applied as a result of the establishment of a customs union are not on the whole higher than the general incidence of the duties which they replace. The Member States base their calculation on the arithmetical average method which is strictly in conformity with the provisions of paragraph 5 of Article XXIV. For arriving at a still lower tariff level, the Member States furthermore in their calculation use the rates actually applied on 1 January 1957, subject to the exceptions as provided for in Article 19 of the Treaty, and not the legal and contractual rates which the Member States, in their view, would have the right to apply under the provisions of paragraph 5 of Article XXIV. To the same effect the Member States provided ceiling rates for a great number of products which have to be

¹⁶⁷WTO (1994)p803.

¹⁶⁸Article XXIV:2(b) of the Geneva Draft Charter. See further, WTO, *ibid.*

¹⁶⁹Geneva Draft Charter, *ibid*

¹⁷⁰GATT, BISD, Sixth Supplement, *supra* note 103, para. 6 at p72.

applied even in the instances where the arithmetical average would lead to higher rates...The Member States are not in a position to accept a country-by-country study for the reasons...given in connection with the interpretation of paragraph 4 of Article XXIV."¹⁷¹

In the examination of the Accession of Greece to the European Economic Community, the EEC argued that the agreement it had concluded with Greece was in compliance with GATT rules including Article XXIV:5(a), as the overall incidence of trade restrictions was expected to decline significantly to the benefit of third countries:

"With reference to Article XXIV:5 and against the background of the very considerable liberalisation of restrictions which would occur in Greece, it was hard to claim that barriers were being created; even if it might be true for one or two products, the overall situation was clearly the opposite. On the question of the alleged inconsistency of this Article with Article XIII, the EC did not consider this point relevant to the Article XXIV:5 exercise; the matter could be further discussed in the context of the relevant Accession Protocols for the countries concerned."¹⁷²

This argument by the EEC was disputed by several members of the Working Party who thought that there was no objective basis for such a statement. Strong views were expressed on the conformity of the Common Agricultural Policy with GATT rules. The fact that Greece was going to apply this policy, in their view, confirmed the non-conformity of the agreement with GATT rules. The inconsistency could not be cured by Article XXIV:5, which did not authorise departures from GATT disciplines on quantitative restrictions:

"[T]he elimination of severe quantitative restrictions on certain Greek agricultural imports would not in fact have a favourable impact on trade, as the quantitative restrictions would, on accession, be replaced by the imposition of variable levies which would effectively preclude imports into Greece from efficient third-country suppliers...[T]he view of the EC that the elimination of quantitative restrictions amounted to a liberalization of imports of the products in question [is without any basis]. One form of restriction had simply been replaced by another which was at least as restrictive as the previous one, but much more unpredictable for third country suppliers...Neither Article XXIV nor the relevant Community legislation required uniformity as to the regulations of commerce of the member States; Greece could thus have maintained its non-discriminatory import regime towards all third countries. Consequently, the

¹⁷¹*Ibid.*

¹⁷²GATT, BISD, Thirtieth Supplement, *supra* note 153, para. 32 at p179.

respective provisions of the Act were not in conformity with the provisions of Article XXIV because duties and other regulations of commerce were more restrictive than before accession".¹⁷³

In the examination of the Accession of Portugal and Spain to the European Communities, the EEC rejected the argument of certain members of the Working Party that Article XXIV:5(a) mandated a detailed examination to determine whether barriers to the trade of any Member had not increased as a result of the enlargement. It insisted that the agreement was consistent with the terms of Article XXIV:5(a), as the acceding countries will lower the barriers to their trade to the level of the Community and that it was unnecessary to carry out a disaggregated analysis under Article XXIV:5(a) :

"...Article XXIV:5(a) only required an examination on the broadest possible basis. The task was general, namely to reach a view on whether the general incidence of customs duties and regulations after enlargement was on the whole more or less restrictive than before. Even if a negative incidence were shown to be the case for certain items, such as when duties were increased or replaced by variable levies, one had to consider whether these effects were not balanced by the effects of other changes in the tariff sector taken as a whole. An overall appreciation of effects of changes in tariffs and regulations of commerce had to be made. In assessing general incidence, one had to avoid too static an analysis and to take into account the trade-creating effects of the establishment or enlargement of a customs union."¹⁷⁴

This argument by the EEC was dismissed by some members of the Working Party who urged a literal interpretation of the terms of Articles XXIV:4 and 5(a). A detailed analysis of the Enlargement Agreement would reveal that Portugal and Spain had adopted measures which had erected or increased barriers to the trade of third countries in violation of Articles XXIV:4 and 5(a):

"The condition of not raising barriers to the trade of other...[Members] contained in Article XXIV:4 was clear and one could not ascribe to it any special subtleties or reservations...The extension of the Communities' Common Agricultural Policy to Spain and Portugal would result in an increase in barriers to third country trade in those countries and a major negative impact on export opportunities [of third countries] generally...It was not tenable to argue that the adoption of the import levy system was a trade liberalizing measure...[T]he Communities' contention that the extension of the tariff of the EC/10 to the EC/12 was compatible with their obligations under Article XXIV:5(a) regardless

¹⁷³ *Ibid*, paras. 27-28 at pp177-178.

¹⁷⁴ GATT, BISD, Thirty-fifth Supplement, *supra* note 107, para. 6 at pp295-296.

of the effect on the tariffs of Spain and Portugal [cannot be accepted]. Article XXIV:5(a) required a comparison with the pre-accession tariffs of the constituent territories and the relative size of those territories was not a relevant factor...[T]he Communities' claim that a deterioration in access for a major item could be adequately compensated by improvements in access in a large number of items of minor trade interest [is not justified]. Nor...[was it acceptable for the Community to claim] that credit was owed to...it because of their own decision to proceed with enlargement."¹⁷⁵

In the examination of the Enlargement of the European Union: Accession of Austria, Finland and Sweden, the European Communities argued that the enlargement agreement was in conformity with the provisions of Article XXIV as it would create trade for the benefit of third parties. The suggestion that it would divert trade from third parties was unfounded, as there would generally be a reduction in the level of barriers that the trade of third parties faced in the new member states. The EC further argued that "there was no provision in Article XXIV that prohibited parties to a regional trade agreement from imposing or increasing a trade barrier. What was necessary under the Article was that the general incidence of duties and other regulations of commerce not be higher than pre-customs union or free - trade area levels."¹⁷⁶

This contention was disputed by several members of the Committee on Regional Trade Agreements including the United States, which thought that the European Union was understating the effect that the enlargement would have on third countries:

"The representative of the United States questioned the statement by the representative of the EC that the enlarged customs union would result in trade creation and generate benefits for third countries. There was the likelihood that third parties would face barriers to their exports, particularly non-tariff measures, as the new Member States adopted the more restrictive policies of the EC. The enlargement of the EC would be at a cost to non-parties...The creation of the EEA [European Economic Area] also had resulted in some costs to the United States, as the EEA countries adopted EC policies which had been more restrictive than those previously maintained by them. The Hormone Directive hampered US trade in beef with the new Member States."¹⁷⁷

The Understanding on the Interpretation of Article XXIV attempts to clarify this requirement by providing that the "assessment shall be based upon an overall

¹⁷⁵*Ibid*, para. 36 at pp310-311.

¹⁷⁶WT/REG3/M/1; 23 April 1997, para. 4 at p2.

¹⁷⁷*Ibid*, para. 40 at p8.

assessment of weighted average tariff rates and of customs duties collected." It further provides that "[t]his assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin."

The view has been expressed that the methodology put forward by the Understanding would not lend itself to easy application perpetuating the earlier difficulties which had been experienced:

"A close reading of the ... [provision] demonstrates ... [that it] provides sufficient room for members of customs unions and non-members to express diverging opinions on the relative weight to be attached to the overall assessment versus a product-specific or country-specific assessment. Moreover, even if attention goes mainly to the overall assessment of a customs union's global tariff schedule, past Article XXIV:5 exercises have shown that an evaluation of weighted average tariff rates on the one hand and of customs duties collected on the other does not necessarily lead to a similar conclusion."¹⁷⁸

The premonition of Youri Devuyt appears to have come true in the sense that questions are still being raised as to the exact scope of this Article. Indeed, it is one of the systemic issues being considered by the CRTA.¹⁷⁹ Given the conclusion of the Appellate Body that Article XXIV:4 does not create a separate obligation, but informs the rest of the Article, it is important for the rights of third countries to be protected under Article XXIV:5.

The critical question is how can the rights of third countries be protected bearing in mind that the very purpose of creating a free - trade area or a customs union is to create trade between the parties. Creating trade between the parties would necessarily entail trade diversion from third countries which may be just as efficient as one or more of the partner countries. Where the external tariff is set at a high level, then it is clear that third countries would lose out. Even where the tariff is set at a very low level, like 1 or 2 per cent, there is still the possibility of trade diversion if one of the partner countries is just as efficient as the third country producer. The optimal result would be

¹⁷⁸Devuyt (1992) p29. See further Srinivasan (1996) pp19-21.

¹⁷⁹See WTO Secretariat (2000a) paras. 62-65 at pp26-28. See further Communication from Hong Kong, China entitled "An Illustrative List of Elements in Article XXIV Requiring Clarification", WT/REG/W/31; 18 November 1998, p2.

to require the parties to the regional trade agreement to extend the same preferences to non-participating countries over a period of time not exceeding ten years after the entry into force of the regional trade agreement.

While this may be the optimal result from a multilateral point of view, very few countries would commit themselves to doing that, as it would be difficult to justify it politically. The concept of reciprocity is so entrenched in trade negotiations that the most liberal of countries in terms of trade policy often eschew free-riding, even though it has been proven that unilateral trade liberalisation benefits the country undertaking it. If the WTO was to insist on automatic extension of preferences to non-participating WTO Members, it would reduce the welfare of some members of the regional trading arrangement, as they would essentially be engaging in free - trade with countries which may have erected enormous barriers to their trade. It has been suggested that this policy may dissuade countries from forming free - trade areas or customs unions, as they would regard the price for WTO's agreement to be too high.¹⁸⁰ In effect, the unintended consequence of this policy would be to keep to a minimum the number of regional trade agreements, thereby ensuring the primacy of the multilateral trading system. Given the fact that this option would place an onerous responsibility on WTO Members and could be considered to be unrealistic, at least in the short term, other options should be explored to guarantee the rights of non-participating countries.

The next best option, in my view, is to require the parties to customs unions to adopt, at the minimum, the lowest MFN tariff on every product which was applied by any of the parties prior to the formation of the union. While this suggestion closely resembles the one earlier proposed, it has certain advantages. Firstly, as it would minimise free-riding to some extent, it is more likely to be acceptable to Members of the WTO than the first option which would have required the parties to regional trade agreements to extend the benefits they have granted to each other to non-participating countries. Secondly, like the earlier proposal, it would obviate the need for complex compensation negotiations, especially where there is no increase in non-tariff barriers. Parties to free - trade areas could be required to narrow the differences between the

¹⁸⁰Srinivasan (1996) p20.

tariffs being applied by them on a particular product using the lowest MFN tariff being applied by one of them as a benchmark.

4.2.2.3.3 *Meaning of "applicable in the constituent territories"*

The precise meaning of the phrase "applicable in the constituent territories prior to the formation of such union" has been the subject of debate for some time. On the one hand, the view has been expressed that when interpreted in context, the word 'applicable' can only mean applied rates of duty prior to the formation of the customs union. On the other hand, the view has been expressed that the benchmark should be the legal or bound rates in the constituent territories prior to the formation of the union.

The issue was given considerable attention during the examination by the Tariff Negotiations Committee in 1961 of the common external tariff of the EEC to determine its compatibility with the provisions of Article XXIV:5(a). Given the divergences in the opinions of the parties and non-parties and the lack of pertinent information, the Committee could not come up with any definitive conclusions. It noted in its tentative report that it had not been "able to reach agreement on the one question which materially affects any attempt to compare tariff rates of the Member States of the EEC before its formation and the Common Tariff, i.e., the question whether, in the case of the former, legal or bound rates on the one hand, or, on the other, rates actually applied should be used". It further noted that:

"The European Economic Community held, on the basis of the text itself of paragraph 5 of Article XXIV, that the expression 'applicable' must be read, in contrast to the term 'imposed' used elsewhere in Article XXIV, as referring to a rule of law which is applied or capable of being applied, and that it is for each contracting party constituting a customs union or a free - trade area to interpret its own legislation with regard to the duties which should be regarded as being applicable. According to the national legislation of the member States of the EEC the term 'applicable' can only refer to conventional (bound) and legal customs duties. Several members of the Working Party, on the other hand, held that 'applicable' must in this context mean rates actually applied since the purpose of Article XXIV:5(a) was to prevent the institution of a customs union being used as an opportunity to increase the protective duties actually encountered by exporters. In particular, it was held by these delegations that the use as a basis for the computation of the Common Tariff of tariffs which were in

fact never levied (i.e. the Italian tariff) did not give a true indication of the protective regime existing before the formation of the customs union."¹⁸¹

After the report was issued, the then Executive Secretary of the GATT, observed that "the result of any statistical exercise would only support the view, with which he thought there was no disagreement, that the incidence of the common tariff was higher than that of the rates actually applied by the member states at the time of the entry into force of the Treaty of Rome."¹⁸²

The Executive Secretary could be said to have implicitly confirmed this observation in a legal opinion prepared by him following a request from certain contracting parties of the GATT. After examining the drafting history of the Article and finding no useful light thrown on the meaning of the word 'applicable', he proceeded to examine the context in which the word was used and the object and purpose of Articles XXIV:4 and XXIV:5:

"...the intent of those who drafted the provisions governing the establishment of a common external tariff of a customs union was that the formation of such a union should not, on the whole, result in higher tariff barriers against trade that *existed* previously in the constituent territories of the union. ...Against this background of the purposes and intent of paragraph 5(a) the two different interpretations of the word 'applicable'... should be examined. It seems that the intentions of the drafters are not fully covered by either interpretation, and yet when the two interpretations are reconsidered from the point of view of reasonableness and logic, the gap between them narrows. On the one hand, if the word were interpreted in the sense of 'applied' duties, it would be reasonable, in the computation of a common external tariff, to permit the use of duties inscribed in the tariff in those cases where duties had been temporarily lowered or suspended to meet particular circumstances of an economic nature or because other types of barriers were being used. On the other hand, if the word were interpreted in the sense of 'applicable' duties, it would be reasonable, in the computation of a common external tariff, to disallow the customs duties of a legal tariff if those duties had never actually been applied and there was no reasonable expectation that they ever would be applied."¹⁸³ (*italics in original*)

In the examination of the Accession of Greece to the European Communities, the issue was not resolved by the Working Party. Whereas the non-participating

¹⁸¹WTO (1994) p805.

¹⁸²*Ibid.*

¹⁸³*ibid* at p806.

countries insisted that the appropriate benchmark was the applied rates of duty, members of the EEC insisted that it was the bound rates that should be taken into account. The argument of the EEC seems to have hinged on the fact that the decision to apply a lower tariff rate than the bound rate is a discretionary one that could solely be made by a Member of the WTO, and as such it would be pure legal fiction if a voluntary decision is to be converted into a legally binding one. The differing views of the parties is captured in the passage below:

"Several members of the Working Party took the view that since it was the task of the Working Party under Article XXIV:5(a), *inter alia*, to make an assessment of the changes in the tariff level of Greece, it was necessary to obtain information not only relating to the bound or legal rates but also to applied tariff rates...The EC replied that for the purposes of the Working Party, only the bound rates were of relevance. Applied tariff rates reflected only temporary conditions and did not constitute an appropriate basis for the examination."¹⁸⁴

Similar interpretative problems have also been encountered in the interpretation of Article XXIV:5(b), which is the corresponding provision for free - trade areas. Although the language used is slightly different, the section seeks to achieve the same objective as Article XXIV:5(a). In the examination of the Free - trade Agreement between Canada and United States, the parties to the Agreement maintained that bound rates should be used in calculating whether duties and other regulations of commerce had become higher or more restrictive than the corresponding duties and other regulations of commerce, while third countries argued that the appropriate benchmark was the applied rates. The passage below captures the differing views of the parties:

"The representative of Canada said that the objective of not raising barriers to the trade of other parties in Article XXIV:4 had to be considered together with the requirements of Article XXIV:5(b). Any judgement on the restrictive effect of eliminating the export-based duty remission scheme compared to the situation prevailing prior to the formation of the free - trade area, should be made with respect to trade in goods with bound tariff rates. Parties to a free - trade agreement did not have the obligation to continue, regardless of the GATT bound rates, the duties applied at lower rates than GATT bound rates through duty remission schemes or temporary reduction or suspension of duties prior to the formation of the free - trade agreement. *The representative of a group of countries* noted with interest that the parties' interpretation of Article XXIV was that the obligation not to increase the restrictiveness of duties related exclusively to bound rates. One member maintained the view that the term "duties" in

¹⁸⁴ *Supra* note 153, paras 19-20 at p175.

Article XXIV:5(b) was not only limited to bound rates but covered all the duties applied by the parties at the time of the formation or enlargement of a free - trade agreement."¹⁸⁵

In the joint examination of the Free - trade Agreements between the European Communities and Bulgaria/European Communities and Romania by the Committee on Regional Trade Agreements, the view was expressed that Article XXIV:5(b) prohibited the increase of MFN tariff rates while the parties were negotiating a free - trade agreement which would abolish substantially all the barriers to their trade. As was put by the United States representative, "[r]aising MFN duties while at the same time negotiating [free - trade agreements] would lead to regional treatment for a significant portion of a country's trade...Such a situation failed the test of Article XXIV:5(b)."¹⁸⁶

The argument of the United States appears to be in conflict with a literal reading of the provisions of Article II of the GATT 1994, which relevantly provides that "each...[Member] shall accord to the commerce of the other...[Members] treatment no less favourable than that provided for in ... Schedule [of Concessions]." Thus, if the bound rate for a particular product is 60 per cent and a country is applying 20 per cent, that country is entitled under this provision to increase the tariff rate to 59 per cent. The effect of the argument by the United States is to prevent Members from increasing their applied rates of duty.

In response to the argument by the United States, the representative of the European Communities said that the position of the United States was "predicated on a reading of Article XXIV:5(b)...not shared by all the Members...That the word 'applicable' had resulted in conflicting interpretations".¹⁸⁷ The representative later asserted that the "conservative definition of 'applicable' in Article XXIV:5(b) had in the

¹⁸⁵GATT, (BISD) Thirty-Eight Supplement, *supra* note 108, para. 62 at p66.

¹⁸⁶WT/REG1/M/1, WT/REG2/M/1, WT/REG7/M/1, WT/REG8/M/1, WT/REG9/M/1; 9 June 1997, para. 19 at p6. See further the examination by the Committee on Regional Trade Agreements of the Interim Agreement Between the European Communities and Poland, (WT/REG18/M/1; 30 May 1997). Japan asserted that Poland was in breach of Article XXIV:5(b) by raising MFN tariffs for automobiles from 15 per cent to 35 per cent while granting a duty-free quota of 30,000 new automobiles to the European Union, which represented a significant proportion of cars imported into Poland each year.

¹⁸⁷*Ibid*, para. 20 at p6.

past meant bound rates, or the rates the Parties could apply and still meet their obligations under the WTO."¹⁸⁸

The Understanding on the Interpretation of Article XXIV resolves this issue by stating that the evaluation under Article XXIV:5(a) in respect of tariffs shall be based on custom duties actually collected. In other words, what is relevant is the applied rates of duty and not the bound rates. The clarification may appear to be at odds with the application of Article II of GATT 1994, under which a Member is entitled to raise its tariffs up to the bound levels at any time without having to provide compensation to interested third parties that may be affected by such increases in the tariff rates.

The logic behind the Understanding appears to be that if Members were allowed to set their common external tariffs on the basis of their bound tariff rates it could lead to massive trade diversion, especially where the agreement involves major trading nations and the difference between the bound rates and applied rates is quite substantial. By mandating that the assessment be based on the applied rates of duty, it is envisaged that the interests of non-participating countries vis-à-vis the parties to the agreement would, to some extent, be preserved. The benefits to third countries could be substantial where the parties to the agreement were applying very low tariffs such as to make the difference between the regional rates of duty and the MFN rates quite inconsequential.

4.2.2.4 *Meaning of “interim agreement”, “reasonable length of time” and “plan and schedule”*

With regard to Article XXIV:5(c), the meaning of the following terms, “interim agreement”, “plan and schedule” and “a reasonable length of time” have provoked controversy. Members have often interpreted the terms to suit their own particular circumstances. The result has been the lack of guidance for WTO Members entering into regional trade agreements.

4.2.2.4.1 *What constitutes an Interim Agreement?*

¹⁸⁸See the joint examination of the free - trade agreements concluded between the European Communities and the Baltic States (Estonia, Latvia and Lithuania), *Ibid*, para. 57 at p12.

The General Agreement does not contain a definition of this term. However, it is clear that the drafters had in mind an agreement that did not immediately commit the parties to abolishing barriers to substantially all the trade between them. Before the entry into force of the WTO Agreement, there was the widespread concern that some Members were abusing Article XXIV:5(c) to maintain indefinitely regional trading arrangements inconsistent with the terms of Article XXIV. In some cases, countries insisted that they were notifying free - trade agreements or agreements establishing customs unions whereas, in fact, they were interim agreements. Broadly speaking, even if the parties undertake to abolish all barriers to their trade within, for example, six months after the entry into force of their agreement, that agreement could still be regarded as an interim agreement. Likewise, if the parties undertake to liberalise a significant proportion of their trade leaving aside a major sector of economic activity for liberalisation at a later period, that agreement could still be regarded as being an interim agreement.

In the examination of the Interim Agreements Between the European Communities and Czech Republic, Slovak Republic, Hungary and Poland, the Chairman in his introductory remarks stated that "the agreements would gradually establish free - trade areas over a maximum period of 10 years, when duties and other restrictive regulations of commerce would have been eliminated on substantially all trade between the signatories."¹⁸⁹ Thus, it was accepted outright by the parties that their agreement was an interim agreement for the creation of a free - trade area. By contrast, in the examination of the Enlargement of the European Union: Accession of Austria, Finland and Sweden, the representative of the EC noted that "most of the trade provisions had become effective as of... [the date of entry into force of the agreement] without any period of transition."¹⁹⁰

It is quite interesting that the representative of the EC implicitly suggested that the enlargement agreement was not an interim agreement, although he accepted that not all the trade provisions had become operational on the date of the entry into force of the agreement. In the examination of the Australia/New Zealand Closer Economic Relations Trade Agreement, the representative of New Zealand insisted that "the

¹⁸⁹WT/REG18/M/1; 30 May 1997, para. 2, p1.

¹⁹⁰WT/REG3/M/1; 23 April 1997, para. 2, p1.

agreement was in no sense provisional or incomplete but a definitive establishment of a free - trade area under Article XXIV...There was, however, an intervening period between entry into force and the complete elimination of duties and other restrictive regulations on substantially all the trade."¹⁹¹

It would appear that under GATT/WTO practice, so far as a substantial proportion of the trade between the parties is liberalised immediately after the entry into force of their trade agreement, that agreement would not be regarded as an interim agreement.¹⁹²

4.2.2.4.2 *What Information should a Plan and Schedule contain?*

The requirement that the parties attach a plan and schedule to their interim agreement is meant to ensure that the parties do not circumvent their obligations under Article XXIV by maintaining indefinitely a regional trading arrangement which does not comply with the terms of Article XXIV. Should the parties provide a plan and schedule, it could be established whether or not they are implementing their obligations as foreseen under their agreement. As was stated by some members of the Working Party in the report on the examination of the European Economic Community – Agreements of Association with Tunisia and Morocco:

"[T]he requirements of a plan and schedule had been expressly inserted into Article XXIV in order to give a minimum guarantee that the regional integration would actually be accomplished, as well as to ensure that full information on the gradual development towards free - trade areas was available, so as to permit maximum certainty with regard to the effects on their trade. They claimed that this aspect of plan and schedule was of fundamental importance to ascertain whether the agreements constituted free - trade areas or mere regional arrangements..."¹⁹³

¹⁹¹The Working Party report (L5664) was adopted on 2 October 1984: see GATT, (BISD) (1985) Thirty-first Supplement, para. 29 at p179.

¹⁹²In the examination of the Agreement between EFTA Countries and Spain, it was contended by the parties "that a study of the practice of GATT showed that the borderline between the two legal concepts of free - trade agreement and interim agreement was not quite distinct." The Working Party report (L5045) was adopted on 10 November 1980: see GATT, (BISD) (1981) Twenty-Seventh Supplement, para. 7 at p129.

¹⁹³GATT, BISD, Eighteenth Supplement, *supra* note 122, para. 17 at pp154-155.

The main issue which has arisen in connection with this requirement is what elements should the plan and schedule contain? Article XXIV does not provide any useful information on this issue leading parties to submit information of uneven quality to Working Parties established under the GATT to examine the consistency of notified agreements with the provisions of Article XXIV.

In the examination of the Association Agreement between Turkey and the European Economic Community, the view was expressed by some members of the Working party that the plan and schedule annexed to the parties' agreement was not comprehensive and could not be considered to be in conformity with the terms of Article XXIV:5(c):

"[t]wo members of the Working Party were of the opinion that the Agreement provided for an indefinite period of preparation and that the time-table contained in the Agreement, which related only to the preparatory stage, could not be considered to constitute a plan and schedule of an interim agreement leading to the formation of a customs union within a reasonable length of time as required in Article XXIV of the GATT. The preparatory stage was, in the final analysis, of undetermined duration...Even when completed, it did not lead to the formation of a customs union but only to the initiation of a transitional stage, the details of which had still to be worked out... and the duration of which was again not conclusively determined...Further, the decision whether to proceed with the formation of the customs union is to be taken only at the end of the preparatory stage having regard to the economic situation of Turkey."¹⁹⁴

The representative of the EEC disagreed that their plan and schedule did not conform to the requirements of Article XXIV:5(c). He argued that the paragraph should be interpreted in its entirety to get its true meaning:

"The Association Agreement, which must be examined as a whole, is an "interim agreement leading to the formation of a customs union" in the sense of Article XXIV:5. It contains a plan and a schedule...[T]he fact that Article XXIV:5 uses the words "interim agreement" indicates rather clearly that the "plan and schedule" need not necessarily be detailed and complete: the CONTRACTING PARTIES have examined other regional agreements which were also somewhat imprecise in this respect."¹⁹⁵

¹⁹⁴The Working Party report (L2265) was adopted on 25 March 1965: see GATT, (BISD) (1965) Thirteenth Supplement, para. 8 at p62.

¹⁹⁵*Ibid*, para. 9 at p62.

While it is true that the plan and schedule should not necessarily be comprehensive, they must be such as to enable the Members to carry out an examination to determine the consistency of the agreement with the provisions of Article XXIV. In the examination of the European Economic Community – Agreements of Association with Tunisia and Morocco, several members of the Working Party echoed this view:

"[A] number of members of the Working Party were of the opinion that no plan and schedule, as provided for in paragraph 5 of Article XXIV, existed. Without a precise and complete plan and schedule, it would be impossible for the CONTRACTING PARTIES to make findings with regard to whether the agreements were likely to result in free - trade areas within a reasonable period and, if necessary, to make recommendations."¹⁹⁶

Under the Understanding on the Interpretation of Article XXIV, it is stipulated that parties to a regional trade agreement "...shall not maintain or put into force, as the case may be, such agreement if they are not prepared" to accept the recommendations of the Committee on Regional Trade Agreement. It follows that where the parties have not annexed a plan and schedule to their interim agreement, they can be ordered by the CRTA to furnish that information.

4.2.2.4.3 *"Meaning of the phrase "within a reasonable period of time"*

During the years of the GATT, the meaning of this phrase generated a lot of controversy among members of working parties established to examine the consistency of agreements with the provisions of Article XXIV. On the one hand, parties to regional trade agreements insisted on a longer time-frame, while third parties urged the elimination of barriers to substantially all the trade between the parties within the shortest possible time.¹⁹⁷ As noted by the WTO Secretariat, "the texts of many agreements contained no references to completion dates, making it unclear whether a given interim agreement had a definite end-point to the period of transition."¹⁹⁸

¹⁹⁶ *Supra* note 122, para. 27 at p157.

¹⁹⁷ During the examination of the Agreement between the European Economic Community and Spain, the parties to the agreement alluded to the fact that the phrase 'reasonable period of time' had not been authoritatively interpreted. They argued that the phrase should be interpreted bearing in mind the other elements of Article XXIV:5(c), including the reference to interim agreement: see GATT, (BISD) (1972), Eighteenth Supplement, para. 22 at p172.

¹⁹⁸ WT/REGW/16; 26 May 1997, para. 33 at p7.

As if it had foreseen the interpretative problems which this phrase would generate, South Africa tabled a proposal at the London session of the Preparatory Committee for a definite time-limit to be indicated instead of leaving it open for Members to decide on a case-by-case basis. Unfortunately, the proposal failed to attract enough support, thus setting the stage for varying interpretations to be given to the phrase.¹⁹⁹ In the examination of the Association Agreement between Greece and the European Communities, some members of the working party expressed the view that the absence of a definite time-limit did not give parties to regional trade agreements the freedom to choose any transitional period. They doubted whether a period of twenty-two years could be considered reasonable within the meaning of Article XXIV:5(c).²⁰⁰

In a number of cases, the working parties were influenced by the varying levels of development of the parties to the agreement. In the examination of the EEC – Agreement of Association with Malta, several members of the working party accepted the principle that it might not always be possible or desirable to have a complete and detailed time-table:

"Most members of the Working Party stated that paragraphs 5-9 of Article XXIV had to be interpreted against the background of paragraph 4...From the point of view of the General Agreement an evolutionary time-table, such as the one presented in this Agreement, was preferable to a precise and detailed schedule in the case of countries with different levels of development. Such a time-table might be more likely to lead to the formation of a customs union within a shorter period...The parties to the Agreement...stated – and several members of the Working Party supported them – that in view of the difference in stage of development of Malta and the Community, the provisions of the Agreement concerning the plan and schedule for the establishment of a customs union represented a realistic approach...Paragraph 5(c) dealt expressly with the case of interim agreements. The very term 'interim' as applied to the notions of 'plan and schedule' and 'reasonable length of time' made it clear that they did not necessarily have to be fixed at the outset in an absolutely specific and detailed manner."²⁰¹

¹⁹⁹WTO (1994) p808.

²⁰⁰The Working Party report was adopted on 15 November 1962: see GATT, (BISD) (1964), Eleventh Supplement, para. 6 at p150.

²⁰¹The Working Party report was adopted on 29 May 1972: see GATT, (BISD) (1973), Nineteenth Supplement, paras 10-12 at pp92-93.

²⁰¹WTO, (1994) p808.

In the examination of the Agreement between the European Communities and Israel, the Working Party could not come to a unanimous decision regarding how to evaluate asymmetrical agreements. The parties' insistence that there was nothing in the language of Article XXIV which prohibited such agreements was not accepted by all the members of the Working Party:

"a member of the Working Party noted the parties' viewpoint that there was nothing in Article XXIV to prevent the time-table for the fulfilment of the reciprocal obligations being phased differently if the parties so agreed. His authorities considered that such a different phasing could be a legitimate matter for concern, especially if the difference were substantial. The representative of Israel did not share this view, especially in the light of the Tokyo Declaration and the need for differential measures providing special and more favourable treatment for developing countries. He said that, in the present instance, the parties' different stages of economic development made the phasing appropriate and compatible with both the letter and spirit of the General Agreement".²⁰²

Recently during the examination of the Customs Union Between the European Communities and Turkey, the representative of the United States expressed some doubts as to whether a period of over thirty years could be considered as reasonable within the meaning of Article XXIV:5(c). In response, the representative of Turkey stated that given the nature of the agreement under consideration, the time-frame was justified:

"[w]hereas the original Association Agreement, signed in 1964, provided for the establishment of a customs union, it did not lay down any specific time-table, given the vastly differing economic conditions in the EEC and Turkey. However, it contained provisions aimed at reducing the discrepancies in the economies of the Parties. The Additional Protocol of 1970, which went into force in 1973, gave an indicative period for the establishment of the customs union. The transitional period of twenty-two years was therefore not very long...It was important to focus on the elements of the customs union rather than the transitional period."²⁰³

The Understanding on the Interpretation of Article XXIV partially resolves this issue by providing that the "reasonable length of time" referred to in paragraph 5(c) of Article XXIV "should exceed 10 years only in exceptional cases." Given the looseness of the language, it is likely that Members may abuse it and attempt to justify agreements

²⁰²The Working Party report was adopted on 15 July 1976: see GATT, (BISD) (1977), Twenty-third Supplement, para. 23 at p63.

with long transitional periods on the basis of their "unique circumstances". The principal weakness of this provision is that it does not spell out when parties to an agreement would be entitled to a longer transitional period. It is foreseen that the transitional periods under the regional partnership agreements that the European Union wants to conclude with the ACP countries would exceed ten years.

²⁰³WT/REG22/M/1; 6 March 1997, para. 28 at p8.

Chapter 5

Relevant Multilateral Rules on Regional Trade Agreements

This section continues with the examination of the relevant multilateral trade rules on regional trade agreements. It focuses on the provisions of Article XXIV:6 - 8 of the GATT 1994.

5.1 *Scope of Article XXIV:6 of GATT 1994*

Notwithstanding the seemingly simple terms of the section, it has proved in practice to be one of the most controversial provisions in the General Agreement. The rationale for this subsection is that non-members of the trading bloc should not be made to lose their benefits just because a group of countries have decided to further liberalise trade amongst themselves. Where the members of a customs union decide to increase a bound tariff on an item, they are expected to enter into negotiations with contracting parties having initial negotiating rights and a principal supplying interest with a view to compensating them for breaching Article II of the General Agreement.²⁰⁴ The European Union, for example, recently compensated a number of countries including Argentina, Australia, Canada and the United States following its expansion to include Austria, Finland and Sweden. No detailed criteria for compensation is provided by the General Agreement, but as provided in Article XXVIII of GATT 1994, the negotiations should aim at maintaining a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in the General Agreement prior to such negotiations.²⁰⁵

Three main interpretative difficulties have been experienced with Article XXIV:6. The first one is how to deal with an increase in a bound rate of duty in some

²⁰⁴In the examination of the Accession of Portugal and Spain to the European Communities, one member of the Working Party expressed the view that "the exclusion of preferential trade was necessary...for the purpose of determining supplier rights in the negotiations conducted under Article XXIV:6": *supra* note 107, para. 36 at p311.

²⁰⁵See Article XXVIII:2 of GATT 1994. Paragraph 10 of the 1980 Guidelines on "Procedures for Negotiations under Article XXVIII" confirms the applicability of the procedures set out under that Article to Article XXIV:6 negotiations.

of the constituent members of the customs union when there has been a reduction in the duty for that specific item in other constituent members of the customs union.²⁰⁶ Some countries have argued that a customs union should not be able to claim credit on account of tariff decreases on the same tariff line by some of its members. In other words, when assessing the impact of the new tariff of the customs union, a disaggregated analysis should be used instead of an aggregated analysis. While this argument may appear persuasive, these countries are in the minority. The majority view is that customs unions should be able to claim credit for decreases made on the same tariff line by some of its members.²⁰⁷ In the examination of the Accession of Portugal and Spain to the European Communities, it was submitted by one member of the Working Party that the term 'compensatory adjustment' should be construed "as implying that a tariff reduction on one item in some constituent territories of the customs union should be taken into account in calculating the amount of compensation for the increase in the tariffs applied to the same item in other constituent territories of the same customs union".²⁰⁸

The Understanding on the Interpretation of Article XXIV has adopted the majority position on this issue by providing that "due account shall be taken of reductions of duties on the same tariff line made by other constituents of the customs union upon its formation".²⁰⁹

The second difficulty which has been experienced with Article XXIV: 6 negotiations for compensation is whether a customs union has the right to ask compensation from non-members where such members would benefit from the import liberalisation measures implemented by the members of the customs union. This kind of credit is known in the literature as "reverse compensatory adjustment". Before the entry into force of the Understanding on the Interpretation of Article XXIV, the EEC always insisted that it had the right to offset reductions in tariffs and other barriers in one sector

²⁰⁶Credit claimed for decreases on the same tariff-line by a customs union is usually referred to as "internal credit". By contrast, "external credit is when credit is sought for reductions on other tariff-lines.

²⁰⁷Devuyst (1992) p23.

²⁰⁸GATT, (BISD) Thirty-fifth Supplement, *supra* note 107, para. 38 at p315.

²⁰⁹See paragraph 5 of the Understanding on the Interpretation of Article XXIV of GATT 1994.

(industrial) against increases in another sector (agriculture) and went as far as to demand compensation from its trading partners when Greece acceded to it on the basis that the liability of third countries in terms of the payment of customs duties and other restrictive regulations of commerce had, on the whole, been reduced so as to ensure their conformity with the common external tariffs and standards set by the community:

"The examination would show that a substantial credit for the enlarged EC existed in the sense that there was considerable movement in Greece towards liberalisation, i.e. greater access and reduction of tariffs for imports from third countries. On an overall basis, the general incidence of all these changes was very positive. In adopting the CCT, Greece was moving from an average duty rate of 18 per cent to one of 4 per cent, or 6 per cent when petroleum products were excluded...The number of tariff bindings applicable to Greece would also increase by a factor of three resulting in a considerable increase in security for the trade of third parties. As regards quantitative restrictions, Greece was liberalising its import regime for about 200 products from the date of accession, and the benefits for third parties were very substantial".²¹⁰

Countries whose trade has been negatively affected by the formation of a customs union have always rejected this argument; they are of the view that customs unions which autonomously reduce tariffs or relax other regulations of commerce should not be able to claim compensation. In other words, they are firmly of the view that when the formation of a customs union results in the reduction of the general incidence of the members' external tariffs, the new rates of duties should be unconditionally extended to the Members of the WTO. In the examination of the Accession of Portugal and Spain to the European Communities, some delegations objected to the approach advanced by the European Communities:

"Some delegations took issue with the European Community's contention that 'credit' was owed to the Communities for the relaxation of non-tariff barriers which had resulted from the accession of Portugal and Spain. The trade liberalization effect of the removal or modification of certain practices was minimal in the agricultural area, since they would be replaced by the Common Agricultural Policy's instrument which would relegate non-EC suppliers to the status of residual sources"

....

"One member of the Working Party considered that the conditions stipulated in Article XXIV could not be presumed fulfilled simply because the customs union had resulted in some minor improvements in market access...[T]he European Communities' view that as a corollary of "compensatory adjustment", a customs

²¹⁰ *Supra* note 153. para. 10 at p172.

union could claim 'counter-compensation' from other contracting parties for the reduction of the general incidence of custom duties resulting from the customs union [is] utterly without any foundation in the GATT".²¹¹

The Understanding on the Interpretation of Article XXIV confirms the view of the majority that the concept of 'reverse compensatory adjustment' has no basis under WTO law. Paragraph 6 thereof provides:

"GATT 1994 imposes no obligation on Members benefiting from a reduction of duties consequent upon the formation of a customs union, or an interim agreement leading to the formation of a customs union, to provide compensatory adjustment to its constituents."

Another problem which has arisen in connection with Article XXIV:6 is the period when the parties to the agreement should enter into compensatory negotiations under the procedures outlined in Article XXVIII of GATT 1994. In a number of cases, the parties unilaterally modified their concessions contrary to the provisions of Article II of GATT 1994 before commencing compensatory negotiations with interested countries. In the examination of the Customs Union Between the European Communities and Turkey, the representative of Thailand criticised the European Union for not following the established procedures:

"It was imperative that Members wishing to form [regional trade agreements] comply with all the relevant multilateral rules including Article XXIV:6, which required parties to RTAs to enter into compensation negotiations under Article XXVIII. A unilateral withdrawal of concessions under Article II of GATT 1994...constitute[d] a breach of the multilateral rules".²¹²

In the examination of the Enlargement of the European Union: Accession of Austria, Finland and Sweden, the representative of the Argentina refused to join the consensus to endorse the new schedule of concessions of the EC on the ground that Argentina had not completed its Article XXIV:6 negotiations with the parties to the agreement.²¹³

²¹¹ *Supra* note 107, para. 24 at p306 and para. 38 at p315.

²¹² WT/REG22/M/1; 6 March 1997, para. 17 at p6.

²¹³ WT/REG3/M/1; 23 April 1997, para. 13 at p4. Argentina was among the more than twenty countries which had entered into compensatory negotiations with the EC.

The Understanding on the Interpretation of Article XXIV resolves this issue by making it clear that compensatory negotiations should be commenced before the parties to a customs union or an interim agreement leading to the establishment of a customs union modifies or withdraws its tariff concessions under Article II of GATT 1994. It would appear that there is no obligation on the parties to conclude the negotiations before withdrawing or modifying their concessions. What is required is the commencement of negotiations with interested parties before proceeding to modify or withdraw concessions.

While the Understanding has managed to clarify most of the interpretative difficulties which have been experienced, some problems remain especially in the area of non-tariff barriers. As pertinently noted in the Understanding, "for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows may be required". The problems which have been experienced in this area would abate if the recommendations made concerning how non-tariff barriers such as quantitative restrictions and rules of origin should be treated were to be adopted.

5.2 *Scope of Article XXIV:7 of GATT 1994*

This paragraph contains one of the most abused provisions of Article XXIV. It obliges parties to regional trade agreements to promptly notify the General Council when they enter into such agreements and attach any relevant information which would enable the Council to make any recommendations it deems appropriate to the parties to the agreement. The purpose of this provision was to give residual control to the General Council over such agreements to ensure that they complemented the multilateral trading system. As the drafting history of Article XXIV demonstrates there was the concern that regional trade agreements could make the task of multilateral trade liberalisation difficult and sometimes work at cross-purposes with it.

By requiring parties to such agreements to submit them to the General Council, which could make binding recommendations to the parties, it was thought that an

effective mechanism had been found which would ensure the complementarity between the two approaches to global trade liberalisation.

Two main difficulties have been experienced with this provision. These relate to when the notification of the agreement should be made to the General Council and the extent of the powers of the Council to make binding recommendations.

5.2.1 *When should notification be made*

A cursory reading of the Article would seem to indicate that notification should be made before the implementation of the agreement by the parties. In practice, however, very few agreements have been notified to the General Council before implementation. In most cases, the parties notify their agreement well after its entry into force in their respective territories. This has been a source of concern to many Members who believe *ex-post* notification of an agreement deprives the General Council of its powers to make binding recommendations to the parties before the implementation of the agreement. This concern led to the adoption of a Council decision in October 1972:

"Without prejudice to the legal obligations to notify in pursuance of Article XXIV, the Council decides to invite [Members] that sign an agreement falling within the terms of Article XXIV, paragraphs 5 to 8, to inscribe the item on the agenda for the first meeting of the Council following such signature, to the extent that the advance notice of ten days prescribed for inclusion of items on the agenda can be observed. Inclusion of the item should allow the Council to determine the procedures for the examination of the agreement".²¹⁴

Notwithstanding this decision, Members continued to notify their agreements after they had been implemented. In the examination of the Customs Union between the European Communities and Turkey, the representative of Hong Kong "regretted that, while the Agreement under review went into force on 31 December 1995, it was not until mid-February of the following year that the WTO was notified of the

²¹⁴The decision was adopted on 25 October 1972; see GATT, Basic Instruments and Selected Documents (BISD)(1973), Nineteenth Supplement, p13.

Agreement."²¹⁵ In response, the representative of the European Communities noted that "it might be impracticable for parties to an RTA to notify their agreement before its implementation."²¹⁶

In the examination of the free - trade agreements between Slovenia and the Baltic States, the representative of the United States asked the parties to the agreement to explain why they had not notified their agreements promptly to the WTO. The representative of Slovenia stated that "as the Agreements dealt with four small countries, the delay in the notifications stemmed from the limited resources of the Parties".²¹⁷ In the examination of the free - trade agreement between Romania and Moldova, the representative of the United States asked the parties to explain why it took them 20 months after the entry into force of the agreement to notify the agreement to the WTO. In response, the representative of Romania stated that "he regretted the late submission of the notification and affirmed that this had not been due to any lack of will by the parties to follow the obligations under the WTO. They had been confronted with a shortage of human resources and had required a long time to think about the rules of GATT, in particular Article XXIV. The conclusion of their reflection was to notify under GATT Article XXIV."²¹⁸

There are a number of reasons why Members choose not to notify their agreements before implementation. The first and most important is knowledge that the examination process of the WTO is too slow and might not yield results at the end. Sometimes, it can take several years before the examination process comes to an end. In the case of MERCOSUR, for example, the agreement was signed by Argentina, Brazil, Paraguay and Uruguay in 1991 and notified to the GATT in 1993, yet as of March 2001, no decision had been made on the compatibility of the agreement with the

²¹⁵ *Supra* note 212, para. 26 at p7.

²¹⁶ *Ibid* at para 27. In the examination of the Interim Agreement Between Slovenia and the European Communities, the representative of the EC stated that "the Agreement had been in force since 1 January 1997 and that it had been notified slightly before that date". He made this observation immediately after the Chairman of the CRTA had noted that the Agreement "had succeeded a Cooperation Agreement between the same parties, signed in 1993 and notified to the WTO in 1995, at which time the negotiations for the conclusion of an interim agreement were already taking place": see WT/REG32/M/1; 12 March 1998, paras 3-4 at p1.

²¹⁷ WT/REG34/M/, para. 7 at p2.

²¹⁸ WT/REG44/M/1; 19 October 1998, para. 6 at p2.

relevant rules of the WTO.²¹⁹ Had the parties not implemented their agreement and waited for the approval of the GATT/WTO, they would have been extremely disappointed. It is interesting to note that after being in force for nearly 45 years, the GATT/WTO has not been able to pronounce on the consistency of the Treaty of Rome with the multilateral trade rules. The examination process ended in deadlock with the six original members of the European Economic Community insisting that their agreement was consistent with the provisions of Article XXIV, whereas non-participating countries expressed strong reservations about that judgment.

With knowledge that the examination process is going to end in deadlock, Members have concluded that it does not make sense to notify their regional trade agreements to the WTO before their implementation. Their position cannot be disparaged, as a lot of economic gains could be lost between the time of notification and the end of the examination process. Such a situation could bring governments in conflict with the business community, especially where no guidance is provided by the WTO after the examination process.

The second reason may be related to the delicate political processes in some Members of the WTO. It has been argued that unless an agreement receives the final imprimatur of the relevant agency of the government, be it the legislature or executive, it would be premature to notify the agreement to the WTO, as there is the possibility that the legislative or executive may reject the agreement and require changes to be made before giving its approval. There is also the view that WTO mandated changes before the implementation of an agreement may create problems domestically, as there would be the perception that a country's sovereignty is being undermined:

"There are different possibilities with respect to the point in time which notification should occur - whether at the conclusion of negotiations, when the agreement is signed, when it is ratified, or when it enters into force. It has been argued that an examination is more meaningful when notification occurs at the earliest possible date, and in particular, when changes can still be made to the

²¹⁹GATT Documents L/7370 and L/7370/Add.1; 18 January 1994. The agreement was signed by the four countries on 26 March 1991 and notified to the GATT Secretariat on 22 December 1993.

agreement by its members. However, *because agreements signed by governments often require legislative or popular approval (for example, by a referendum), if notification occurred at a point prior to entry into force, the contracting parties would, in some cases, review agreements which were eventually rejected by one or more of the countries involved. Alternatively, if agreements are examined only after a protracted and perhaps difficult process of domestic legislative approval, the prospect of amending an agreement to reflect the concerns of GATT contracting parties presents its own difficulties.*"²²⁰(emphasis added).

To redress this problem, it has been suggested that the WTO should allow counter-notifications of agreements by Members who are not parties to the agreement. Under this proposal, examination of the agreement would proceed with or without the consent of the parties. While this proposal merits serious consideration, it is doubtful whether it could redress this problem. Without the active participation of the parties in the examination process nothing much could be achieved. It is in the light of this that it has been suggested that "Members, through the [CRTA], could urge parties to comply with their notification obligations."²²¹

5.2.2 *What kind of Recommendations could be made by the General Council*

It is clear from a reading of Articles XXIV:7(a) and (b) that the General Council has the power to make recommendations to the parties if it believes that certain provisions of the agreement are not in conformity with the multilateral rules. This view is supported by the preparatory records of the General Agreement:

"there is no question of the [General Council]...having any power to approve or disapprove a Customs Union...if a country which is a Member of this Agreement enters into an arrangement with another country...which involves preferential arrangements which are not consistent with its obligations under Article I, and justifies that departure from its obligations on the ground that it is a step toward a Customs Union, then the contracting parties should have a chance to have a look at those proposals and see whether they are in fact as represented. If the [General Council] find that the proposals made by the country that is making them will in fact lead towards a Customs Union in some reasonable period of time...they [will] approve it. They have no power to object. It is simply a mechanism foreseeing, if necessary, that some Member does not find a way out of its obligations under Article I under the guise of

²²⁰Sampson (1994) pp10-11.

²²¹WT/REG/W/9; 9 October 1996, para. 5 at p3.

entering into a Customs Union when it is really not likely that a Customs Union will eventuate."²²²

It would appear that the powers which could be exercised by the General Council include requiring the parties to the agreement to phase out their restrictions on each other's trade within a shorter period of time than originally envisaged in the agreement and also to broaden the coverage of their agreements to include sectors or subsectors of their economies which had been excluded. They could also require the parties to reduce the general incidence of duties and other regulations of commerce including lowering the threshold of their rules of origin.

A close reading of the article would seem to indicate that it was the intention of the drafters of the General Agreement that this power of the General Council would be exercised before the implementation of the agreement by the parties. However, as discussed in the next chapter, the General Council has rarely had the opportunity to examine an agreement before its implementation. The problem could be mitigated, if the decision-making process of the Committee on Regional Trade Agreements were to be improved. So far as there is the perception that the Committee is weak and incapable of arriving at unanimous decisions regarding the consistency of agreements with the relevant multilateral rules, very few Members would find it necessary to notify their agreements for examination before implementing them. Members would comply with the provisions of Article XXIV:7, only when there are incentives to do so.

This development has rendered the article incapable of fulfilling the purpose for which it was inserted into the General Agreement. This situation has generally made it possible for WTO Members to maintain agreements whose provisions are not always in conformity with the rules of the WTO.

5.3 *The scope of Article XXIV:8 of GATT 1994*

The purpose of this requirement is said to be a "public choice one": it is an attempt to ensure that participants in regional liberalisation efforts go all the way.²²³ It is as such

²²²WTO (1994) p816.

²²³Hoekman (1995) p51.

designed to constrain the ability of participating countries to violate their MFN obligations selectively. Generally, customs unions and free-trade areas are thought to be welfare-enhancing, while preferential trading arrangements, in which only a few sectors are liberalized, are generally perceived to be protectionist and not in the general interest of the multilateral trading system. In his seminal work on customs unions, Jacob Viner introduced the terms "trade-creation" and "trade-diversion".²²⁴ Trade creation, according to his theory, was likely to occur if members of a regional trading arrangement substantially liberalised their economies. The abolition of tariffs and other barriers to intra-trade would ensure that the most efficient producer got the opportunity to produce the goods cheaply for the entire customs union or free-trade area, thus enhancing consumer welfare and promoting efficiency gains. By contrast, if there were to be partial liberalisation, there was the likelihood of trade diversion resulting from the trading arrangement, as members of the customs union or free-trade area will simply be substituting high-cost producers in their respective countries with those from the other participating countries, who may not be the most efficient producers of the product in question in the world.

The question which has sharply divided trade ambassadors, lawyers and economists is how much liberalisation should occur before the constituent territories could be considered to have satisfied the test in Article XXIV:8. As was noted by Australia in a communication to the Committee on Regional Trade Agreements, "[a]n agreed understanding of the meaning of "substantially all the trade" has so far eluded the [GATT/WTO] membership."²²⁵ The absence of such an understanding is one of the main reasons why most Working Parties established to examine the GATT-conformity of regional trade agreements have not been able to arrive at a clear-cut decision".²²⁶ Two distinct schools of thought have emerged in relation to the proper interpretation of the phrase 'substantially all the trade', namely the quantitative group and the qualitative group.

5.3.1 *The Quantitative approach*

²²⁴Viner (1950) pp41-56.

²²⁵WT/REG/W/22; 30 January 1998, para. 1 at p1.

²²⁶WT/REG/W/22; 30 January 1998, para. 2 at p1. See further "Communication from Australia", WT/REG/W/18; 17 November 1997.

Proponents of this approach are of the view that the test in Article XXIV:8 requires parties to regional trade agreements to liberalise a significant proportion of the trade between them. In the examination of the Treaty Establishing the European Economic Community, the representatives of the six participating countries expressed the view that the test would be satisfied, if 80 per cent of the volume of trade between the parties was liberalised.²²⁷ This view was not shared by a majority of the members of the Working Party who preferred a flexible approach under which each case would be examined on its merits:

"Many members of the Sub-Group said that each case of a proposed customs union or free-trade area had to be considered on its merits and that it was, therefore, inappropriate to fix a general figure of the percentage of trade which could be subjected to internal barriers without running counter to the definition in paragraph 8(b) of Article XXIV. A matter to be considered was whether the provisions of a free-trade area pointed towards a gradual increase of barriers affecting the trade between the constituent parties or a gradual reduction of such barriers. Moreover, any calculation of the percentage of trade not freed from barriers would need to take account of the fact that this trade would be, or would have been, larger if the trade had been allowed to flow freely. Some members of the Sub-Group thought that it would be unrealistic to apply the same criterion to a free-trade area such as that existing...[between developing countries] and to a free-trade area the members of which were highly industrialized countries accounting for a large percentage of world trade."²²⁸

While the quantitative approach offers an insight into the level of liberalisation of the trade between the parties, it has some conspicuous drawbacks. It could provide parties to regional trade agreements with the opportunity to maintain barriers in the so-called sensitive sectors such as agriculture and textiles and clothing. In other words, the selectivity associated with the quantitative approach appears to be its main weakness. As observed by Australia:

"At first glance, it might seem advisable to use actual trade statistics and trade flows in an assessment of the extent to which the substantially-all-trade criterion has been met. There are, however, some difficulties associated with this.

²²⁷ *Supra* note 103 at para. 33 at p100. See further the report of the Working Party in the examination of European Communities - Agreements with Portugal which was adopted on 19 October 1973: see GATT, (BISD)(1974), Twentieth Supplement, para. 16 at p176, where the representative of the EC observed that "no exact definition of the expression ['substantially all the trade'] existed and that the precise figures would vary from case to case according to several factors. At any rate, percentages were established as a general indicator of the trade covered by the Agreement and were not to be regarded as a conclusive factor".

²²⁸ GATT, (BISD), Sixth Supplement, *supra* note 103, para. 34 at p100.

Participants in several working parties established to examine free - trade agreements and customs unions have recognized that any calculation of the percentage of trade not freed from barriers would need to take account of the fact that this trade would be, or would have been, larger than if the trade had been allowed freely...[S]imply looking at trade flows does not take account of the dynamics at work before the conclusion of an arrangement, its implementation and the situation prevailing once it has been fully implemented".²²⁹

To reduce the selectivity associated with the quantitative approach, Australia suggested that the figure proposed by the EEC be increased to 95 per cent and that consideration should be given to using the Harmonized Commodity Description and Coding System as a benchmark for determining whether the arrangements meet the target figure:

"[S]ubstantially all the trade' should be defined as coverage by a free - trade agreement or an agreement establishing a customs union of 95 per cent of all the six-digit tariff lines listed in the Harmonized System. This approach would ensure that there is sufficient flexibility to set aside product areas that for one reason or another cannot yet be traded between the partners free of restrictions...One advantage of proceeding in this way is that it would not be necessary to discover the extent to which trade in a given product may have been affected by other measures in place. Additionally, it is unlikely that this approach would permit the carving-out of any major sector because of the strong possibility that the permitted exemptions would have to be spread out over a range of potentially sensitive sectors...[T]his type of approach...has the great advantage of being easily verifiable without requiring complex econometric work."²³⁰

Notwithstanding its simplicity and ease of application, the Australian proposal has not been approved by the Committee on Regional Trade Agreements. It could be argued that the Australian suggestion has no textual basis and would appear to be reading too much into the language agreed by the Members of the WTO. The choice of 95 per cent appears to be arbitrary and seems to have no regard for the ordinary meaning of the phrase 'substantially all the trade'. As has been pointed out by the European Communities, substantial does not mean 'all', and that Members have the flexibility to decide which sectors they wanted to carve out of their trade agreement.²³¹ Presumably the argument could be made that approval of the Australian proposal by the Committee on

²²⁹ *Supra* note 225, para. 8 at p3.

²³⁰ *Supra* note 225, paras 10-13.

²³¹ In the joint examination of the interim agreements between the European Communities and the Czech Republic, Hungary, Poland and the Slovak Republic, the representative of the European Communities stated that "the word 'substantially' qualified the

Regional Trade Agreement would mean that Members had taken the decision, albeit indirectly, to amend the provisions of Article XXIV of GATT 1994.

5.3.2 *The Qualitative Approach*

Proponents of this approach argue that for the test in Article XXIV:8 to be satisfied, the regional trade agreement should not exclude any major sector of economic activity. The principal objective of this group is to ensure that the so-called sensitive sectors such as agriculture and textiles and clothing are not carved out of any agreement. They argue that the fact that these two sectors usually account for a small proportion of the trade flows between the constituent territories is not reason for them to be excluded. They see their exclusion as nothing more than a protectionist response to the demands of special interest groups.

In the examination of the Agreement Establishing the European Free-trade Area, the view was expressed that the exclusion of agriculture from the coverage of the Agreement was not in conformity with the letter and spirit of the provisions of Article XXIV:8:

"The Working Party considered first whether the requirement relating to 'substantially all the trade' in Article XXIV:8(b) was met in the case of the Stockholm Convention. The view was put forward that, as the provisions of, *inter alia*, Articles 3 and 10 of the Convention relating to the elimination of barriers to trade in the free-trade area did not apply to trade in agricultural products, it could not be maintained that duties and other restrictive regulations of commerce were being eliminated on 'substantially all the trade'. It was also contended that the phrase 'substantially all the trade' had a qualitative as well as a quantitative aspect and that it should not be taken as allowing the exclusion of a major sector of economic activity. For this reason, the percentage of trade covered, even if it were established to be 90 per cent, was not considered to be the only factor to be taken into account".²³²

The parties to the agreement accepted that both elements (i.e. quantitative and qualitative) were relevant in determining whether or not an agreement satisfied the test in Article XXIV:8. They asserted, however, that it was incorrect to allege that

phrase 'all the trade'. A free - trade area did not mean complete free - trade; otherwise the word 'substantially' was meaningless": see WT/REG1/M/2; 3 October 1997, para.14 at p4.

²³²The Working Party report (L/1235) was adopted on 4 June 1960: see GATT, (BISD)(1961), Ninth Supplement, para. 48 at p83.

agriculture was excluded from the coverage of the agreement, as barriers were to be removed on one third of total trade in agricultural products. The parties rejected the argument by third countries that it was not enough for only one member of the arrangement to reduce barriers to the trade in agricultural products:

"The member states did not accept the contention that they should not take credit for the removal of barriers to trade on a product unless such barriers were removed by all the member States...It was important to note that the phrase used in Article XXIV was 'substantially all the trade' and not 'trade in substantially all products'. Some members might wish to avail themselves of this latitude in respect of different products. The member states did not claim that free - trade would be achieved in the case of all agricultural products, but they did consider themselves entitled to take into account the trade affected by the complete removal of barriers under the agricultural agreements for certain products when assessing the total amount of trade freed under the free - trade area arrangements."²³³

The Working Party was not able to arrive at any decision making it possible for parties to regional trade arrangements to exclude the so-called "sensitive sectors" from the coverage of their agreements and claim consistency of their agreements with the relevant rules of the GATT/WTO:

"There was, therefore, a divergence of view regarding the justification for including, in estimating the amount of trade within the free-trade area to be freed from barriers in terms of Article XXIV, the trade in agricultural products where imports were freed from barriers in terms of Article XXIV, the trade in agricultural products where imports were freed in the case of one member state only. In the time at its disposal, the Working Party was unable to reach agreement concerning the interpretation which should be given to the relevant provisions of Article XXIV."²³⁴

In the examination of the Free - Trade Agreement between Canada and the United States, the view was expressed by a member of the Working Party that the agreement would not be consistent with the provisions of Article XXIV:8, as it permitted the parties to exclude certain agricultural products from the coverage of the agreement:

"The Working Party generally recognized that, in terms of its coverage, this Agreement was one of the more comprehensive free-trade agreements examined

²³³ *Ibid*, para. 51 at pp84-85.

²³⁴ *Ibid*, para. 54 at pp85-86.

in the GATT so far. The...Agreement did not attempt to exclude the whole of the agricultural sector from its coverage. Nevertheless several members raised doubts as to consistency of the Agreement with the definition of a free-trade area in Article XXIV:8(b) and as to whether it covered 'substantially all' the trade between the parties. These members remained concerned about the exceptions allowing restrictions on trade between the two parties in a number of specific products. ...The representative of Canada pointed out that the measures on fresh fruit and vegetables and on meat goods could not be considered as restrictions that were maintained currently between the two parties...[T]he provisions related to emergency arrangements for addressing any unforeseen developments in these sectors."²³⁵

In the examination of the EC-Bulgaria and EC-Romania Interim Agreements, there was a debate in the Committee on Regional Trade Agreements whether parties to a regional trade agreement could exclude agriculture from the coverage of their agreement. Whereas a number of third countries expressed the view that the exclusion of agriculture would not be in conformity with the provisions of Article XXIV:8, the parties to the agreement had a different view and argued, by implication, that it is the quantitative approach which should be taken into account in determining the consistency of an agreement with the multilateral trade rules. The representative of the United States expressed some doubts about the accuracy of this argument in a question posed to the parties to the agreement:

"Would trade liberalization provided for in the Agreement be extended to other agricultural products currently excluded? If so, when? Why had so many important items been excluded in Annex I?... [T]he assessment of the "substantially all the trade" condition could not be made solely on a mathematical basis, particularly if there were items where no trade currently existed due to normal trading patterns or to restrictive trade barriers. If normal trade patterns were the cause, it did not make sense to exclude them from FTA coverage. If not, the only possible conclusion would be that the elimination of duties and other trade measures was not intended for these items on any basis. Thus, "substantially all the trade" could not be met by excluding large numbers of items from liberalization. To comply with Article XXIV, the Parties to the Agreement should extend the Agreement to those products currently excluded, particularly to agricultural products."²³⁶

²³⁵GATT, (BISD), Thirty-Eighth Supplement, *supra* note 108, para. 83 at p73. The restrictive measures covered the following products: "the snapback mechanism for fresh fruit and vegetables, quantitative restrictions on meat goods, import permit requirements on grain and grain products, restrictions on poultry and eggs and on dairy products, and restrictions on products containing more than 10 per cent sugar."

²³⁶ WT/REG1/M/1; 9 June 1997, para. 29 at p8.

In the examination of the Interim Agreements between the EC and the Czech Republic, Hungary, Poland and the Slovak Republic, the same issue arose. The representative of Australia expressed the view that the agreement did not comply with the "substantially all the trade requirement", as there were significant barriers in trade in agricultural products. For the requirement to be met, there needed to be free - trade in agricultural products.²³⁷ This view, which was endorsed by Japan, was dismissed by the European Union which expressed the view that it was based on an erroneous interpretation of the terms of Article XXIV:8:

"The word "substantially" qualified the phrase "all the trade". A free-trade area did not mean complete free - trade; otherwise the word "substantially" was meaningless."²³⁸

It is quite difficult to reject the argument of the European Union on this point. The use of the word "substantially" means that it was never intended that parties should eliminate barriers on all products originating in their territories. If the obligation laid down in Article XXIV:8 is interpreted to mean that parties to regional trade agreements are not permitted to retain a few barriers to their trade, then there would be no use for the word "substantially". Such an approach would undermine the principle of effective treaty interpretation which was espoused by the Appellate Body in *United States - Standards for Reformulated and Conventional Gasoline* (WT/DS2/AB/R). There, it held that:

"[O]ne of the corollaries of the 'general rule of interpretation' in the Vienna Convention is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."²³⁹

As this was one of the most contentious issues during the Uruguay Round, it would have been expected that Members would have resolved the issue decisively in terms of making it clear whether parties to a regional trade agreement could exclude certain products from the coverage of their agreement. After protracted negotiations,

²³⁷ WT/REG1/M/2; 3 October 1997, para 11 at p3.

²³⁸ *Ibid*, para. 14 at p4.

²³⁹ DSR.1996: 1, p21. See further *Japan - Taxes on Alcoholic Beverages*, DSR, 1996:I, p106."

Members left Article XXIV:8 intact and stated in the preamble to the Understanding to Article XXIV that:

"Recognizing also that such contribution is increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded."

This preambular language has been the subject of intense debate. On the one hand, it has been relied upon by third countries to substantiate their claim that it is not permitted for parties to regional trade agreements to exclude the so-called sensitive sectors from the coverage of their agreements. On the other hand, proponents of the quantitative approach argue that not much weight should be attached to the preambular language, as it does not amend or modify the express words of Article XXIV:8. In EC and the Czech Republic, Hungary, Poland and the Slovak Republic, the Australian representative argued that the Understanding obliged parties to a regional trade agreement to include all sectors:

"the WTO Understanding on the Interpretation of Article XXIV of the GATT clearly referred to a diminished contribution to the WTO system if any major sector of economic activity were excluded. Notwithstanding the "coverage" of agriculture in these Agreements, the sector was, in effect, excluded from the obligations of Article XXIV."²⁴⁰

The representative of the European Union disagreed and stated that the Australian representative had misconstrued the significance of the preambular language. He argued that too much had been read into the Understanding and that Members were not obliged to liberalise all their trade:

"The question of sectoral coverage or exclusion had emerged in successive GATT working parties, and the difficulty of making sense of the concept "substantially all the trade" had been reflected by the references in the WTO

²⁴⁰*Supra* note 237. An earlier suggestion by the Chairman of the Negotiating Group on GATT Articles that the phrase "substantially all the trade" be qualified as follows was not accepted: "The requirement that duties and other restrictive regulations of commerce be eliminated with respect to 'substantially all the trade' cannot be satisfied if such elimination does not apply to any major sector of economic activity.": see WTO Secretariat, "Systemic Issues Related to "Substantially All The Trade": Background Note", WT/REG/W/21; 28 November 1997, para. 8 at p3.

Understanding on the interpretation of Article XXIV of the GATT, which stated that the Members of the WTO recognised that the contribution to the expansion of world trade was diminished if any major sector of trade was excluded. The reference was to trade being excluded, not to trade being "in effect excluded". The Australian argument stretched the words of the Understanding without shedding further light on what was actually meant by "substantially all the trade". Exclusion was an absolute state and the agricultural sector was not excluded. Rather, it was covered and had been liberalised within the ambit of these Agreements, though it was true that there was not free - trade in agricultural products."²⁴¹

In effect, the Understanding on the Interpretation of Article XXIV failed to dispel the confusion surrounding this provision. Realising that without an authoritative interpretation of this phrase, it would be difficult to assess the compatibility of an agreement with the multilateral trade disciplines, a number of WTO Members including Australia and Hong Kong, China have made a number of proposals bearing in mind the contribution which could be made by regional trade arrangements in the process of global trade liberalisation. These proposals all aim at preventing parties from concluding narrow discriminatory trading arrangements.

In a communication from Australia to the Committee on Regional Trade Agreements, Australia argued for a combination of the two approaches. as each has its strengths and weaknesses:

"The CRTA might therefore consider what the respective advantages and disadvantages of the qualitative and quantitative approaches are. Some threshold questions in such a consideration could be the definition for the purposes of Article XXIV of a sector or a major sector, and what percentage figure could legitimately be considered to cover substantially all trade. Both approaches have their advantages. That of the qualitative approach is that it leaves out no major sector. This is important particularly where a reduced amount of trade in a sector takes place because of other policies in place. The quantitative approach sets a benchmark which can be verified against the statistical evidence. A successful solution to this problem probably will combine elements of both schools, provided one accepts that a certain level of discipline is desirable."²⁴²

²⁴¹ *Supra* note 237, para.14 at p4.

²⁴² WT/REG/W/18; 17 November 1997, paras 10-12 at p2. See further communication from Hong Kong to the CRTA, WT/REG/W/19 dated 17 November 1997, paras 14-16 at p3: "[t]he meaning of the word "substantially" is imprecise. It obviously means less than quite close to the whole, but how close it approaches completeness is far from clear. It is also open to discussion whether the meaning of "substantially" should be interpreted quantitatively, qualitatively, or both... It is also for consideration whether a single definition or threshold for the word "substantially" should be pursued in numerical terms...[T]he expressed purpose of a

Subsequent to this communication, Australia proposed a formula which would ensure that parties to regional trade agreements actually liberalise trade between themselves across all sectors:

"Our proposal is that "substantially all the trade" should be defined as coverage by a free - trade agreement or an agreement establishing a customs union of 95 per cent of all the six-digit tariff lines listed in the Harmonized System. This approach would ensure that there is sufficient flexibility to set aside product areas that for one reason or another cannot yet be traded between the partners free of restrictions. One advantage of proceeding in this way is that it would not be necessary to discover the extent to which trade in a given product may have been affected by other measures in place. Additionally, it is unlikely that this approach would permit the carving out of any major sector because of the strong possibility that the permitted exemptions would have to be spread out over a range of potentially sensitive sectors...[This] workable definition...has the great advantage of being easily verifiable without requiring complex econometric work."²⁴³

While a number of countries have expressed support for the Australian proposal, others also believe that the figure of 95 per cent is arbitrary and fail to see how the proposal would ensure that regional trade agreements remain supportive of the multilateral trading system. Australia accepts that the figure of 95 per cent is arbitrary, but argues that since "substantially all the trade" does not mean all the trade between the parties, "the criterion, expressed numerically, therefore has to be below 100 per cent...The higher the figure is, the more it will contribute to trade liberalisation between the parties."²⁴⁴

As of March 2001, the Committee on Regional Trade Agreements had not adopted the Australian proposal, notwithstanding the realisation that the lack of a

customs union "to facilitate trade between constituent territories and not to raise barriers to trade of other contracting parties with such "territories" should also have an impact on the consideration of this issue."

²⁴³WT/REG/W/22; 30 January 1998, paras 10-13 at p3. In its response to a comment as to whether or not the figure of 95 per cent would apply to the trade of all the parties to a regional trade agreement, Australia replied as follows: "The figure of 95 per cent would apply to any arrangement regardless of the number of parties. Between them, the parties would be able to exempt 5 per cent of all six-digit tariff lines as listed in the Harmonised system (HS) from the requirement spelt out in GATT Article XXIV:8. How they would share out the 5 per cent would reflect the particular circumstances of the economies involved. The actual division of the available tariff lines would be done through negotiations between the prospective parties to the arrangement. In the same vein, if, for example, three economies were to participate, each would be entitled to a notional 1.66 per cent of exceptions." WT/REG/W/22/Add.1; 24 April 1998, para. 3 at pp1-2.

workable definition of the phrase "substantially all the trade" was partly responsible for the slow progress being made by the CRTA in evaluating the consistency of agreements with the relevant multilateral trade rules.

Before making my recommendation on this thorny issue, it is important to return to the reasons why the drafters of the General Agreement insisted on the parties removing barriers on substantially all their trade. If it were to be established that they thought that would further the goal of multilateral trade liberalisation, then it would appear to be logical to insist on the parties complying with a higher threshold as has been suggested by Australia. In his seminal work on the Havana Charter, which would have established the International Trade Organization, Clair Wilcox explained the dominant thinking at that time:

"A customs union creates a wider trading area, removes obstacles to competition, makes possible a more economic allocation of resources, and thus operates to increase production and raise planes of living. A preferential system, on the other hand, retains internal barriers, obstructs economy in production, and restrains the growth of income and demand. It is set up for the purpose of conferring a privilege on producers within the system and imposing a handicap on external competitors. A customs union is conducive to the expansion of trade on a basis of multilateralism and non-discrimination; a preferential system is not."²⁴⁵

If the broad thrust of Wilcox's statement is to be accepted, as it should be given that his theory is widely accepted by contemporary economists, then it would make sense for the CRTA to adopt the Australian proposal, or even go further by requiring parties to customs unions or free - trade areas to eliminate barriers to all their trade. The latter suggestion has some clear advantages in that it would be easier to apply and monitor. Furthermore, it could act as a brake on the proliferation of regional trade agreements, as almost every country would like to protect a certain sector, even if for a temporary period.

5.3.3 *Other Interpretative problems with Article XXIV:8*

5.3.3.1 *Unilateral Trade Preferences*

²⁴⁴ WT/REG/W/22/Add.1; 24 April 1998, para. 2 at p1.

²⁴⁵ Wilcox (1949) pp70-71.

For some time, it was strongly debated whether agreements under which developed countries granted unilateral trade preferences to developing countries were consistent with the obligation that the parties should eliminate barriers to "substantially all the trade" between themselves. It was argued by third countries that unilateral trade preferences by definition excluded a significant proportion of trade from the coverage of the agreement, unless of course the preference-receiving country has no or very little trade. In the examination of the first ACP-EEC Convention of Lomé (Lomé Convention), the view of the parties that their agreement complied with the relevant provisions of the GATT was challenged by some members of the Working Party, who thought that Article XXIV obliged parties to undertake reciprocal commitments:

"[It was]...noted that ACP countries were not required to assume, in respect of imports of products originating in the EEC, obligations corresponding to the commitments entered into by the EEC as might be expected in any regional trading arrangement...The lack of universality in the treatment applied to developing countries [was also noted]...This indicated that the Convention had a number of elements which constituted significant exceptions to the fundamental provisions and

principles of the General Agreement."²⁴⁶

In the examination of the Trade and Commercial Relations between Australia and Papua New Guinea, the parties to the agreement argued that their agreement was consistent with Article XXIV:8, as the bulk of the trade between them would be liberalised. According to them, that assessment was not affected by Papua New Guinea not giving reciprocal access to Australian exports:

"The representative of Australia stated that although Papua New Guinea would not be extending any reverse preferences to Australia under the Agreement, trade statistics showed that substantially all the trade was covered within the meaning of Article XXIV:8(b). It was pointed out in that connection that Article

²⁴⁶The Working Party report (L/4369) was adopted on 15 July 1976: see GATT, (BISD) (1977) Twenty-third Supplement, para. 25 at p54. See further the Second Lomé Convention, where it was argued by representatives of the ACP states that they were not obliged to give reverse-preferences to the member states of the EEC, although they had given such preferences under the Yaoundé Convention, the predecessor Convention of the Lomé Convention: The Working Party report (L/5292) was adopted on 31 March 1982: see GATT, (BISD) (1983) Twenty-ninth Supplement, para. 17 at p123.

XXIV did not contain any specific provision with respect to reverse preferences. The absence of reverse preferences in favour of Australia did not, in the view of his authorities, affect the free - trade area status of the Agreement."²⁴⁷

Some members of the Working Party disagreed with this view and stated that Article XXIV:8 required parties to regional trade agreements to give reciprocal access to each other's market:

"Some members expressed doubts about the conformity of the Agreement with the provisions of Article XXIV, since it appeared that no reciprocal reduction of duties or elimination of other restrictive regulations of commerce by Papua New Guinea had been required. ... One member... stated that he did not share the view expressed by the representative of Australia that, in the light of the fact that Article XXIV made no mention of reverse preferences, reciprocity was not required between the partners to free - trade area agreements."²⁴⁸

The issue was again contested in EEC - Member States' Import Regimes for Bananas. There, a number of banana producing countries (Colombia, Costa Rica, Guatemala, Nicaragua and Venezuela) contested the compatibility of the third Lomé Convention with the rules of the WTO. The EEC argued forcefully that the Convention was compatible with the provisions of Article XXIV when read together with Part IV of the GATT. This was disputed by the complaining countries, which argued that for an agreement to meet the test laid down in Article XXIV:8, the parties must each grant reciprocal access to each other's market. The panel rejected the argument of the EEC and held that the Convention was not consistent with the provisions of Article XXIV:

"The Panel noted that Article XXIV:8(b) clearly defined free - trade areas as areas in which duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories, not merely on the imports into one of the constituent territories. The Panel noted that the EEC itself considered that the preference was justified not by Article XXIV on its own, but by Article XXIV taken in combination with the provisions of Part IV of the General Agreement."²⁴⁹

It is believed that this ruling of the Panel influenced the EEC and ACP states to seek a waiver from the provisions of Article I to implement the fourth Lomé Convention. It could thus be taken to be fairly established that non-reciprocal regional

²⁴⁷ The Working Party report (L/4571) was adopted on 11 November 1977: see GATT, (BISD) (1978) Twenty-fourth Supplement, para. 7 at p64.

²⁴⁸ *Ibid*, para. 11 at pp65-66.

trade agreements cannot be justified under the provisions of Article XXIV. With the proliferation of regional trade agreements between developed and developing countries, there is pressure from some developing countries to amend the provisions of Article XXIV to take into account the varying levels of development of the parties to the agreement. In the context of the negotiations for a successor agreement to the Lomé Convention, the ACP states have called for a flexible interpretation of the provisions of Article XXIV, so as to allow them to undertake few commitments. An asymmetrical agreement, they argue, would be more in tune with their development needs and strategies.

5.3.3.2 The meaning of duties and other restrictive regulations of commerce

Interpretative difficulties have been experienced with the phrase "duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX)". The problems have basically revolved around three issues, namely, the meaning of "duties", the meaning of "other restrictive regulations of commerce" and the scope of the exceptions.

5.3.3.2.1 The Meaning of "Duties"

It has been debated for sometime whether the term "duties" refers exclusively to custom duties, or covers revenue duties, fiscal charges and measures having a similar effect. The issue was raised during the examination of the Association Agreement between the EEC and African and Malagasy States. Some members of the Working party expressed the view that the continued imposition of fiscal charges by certain parties to the Agreement violated the provisions of Article XXIV:8(b), which required parties to eliminate duties and other charges of equivalent effect on substantially all their trade:

²⁴⁹ DS32/R; 3 June 1993, para. 368 at p81.

"[It was not considered] a reasonable interpretation of the meaning of "free - trade" to look only at the elimination of a minor charge such as 5 or 10 per cent on imports from the Community, while other charges of much higher levels (some over 100 per cent), having no counterpart in the internal taxes of the Associated States, continued to be applied to imports from all sources including the Community. While it was true that in many cases the products involved were not produced locally, the effects of these charges were restrictive and should be eliminated if the intention of the parties was to establish free - trade areas in accordance with the provisions of Article XXIV:8(b)."²⁵⁰

The same issue arose in EEC - Agreement of Association with Malta. There, the view was expressed that Article XXIV:8 of the GATT required parties to a regional trade agreement to remove custom duties and other charges on substantially all the products traded between them, and as this was not the case under the agreement, its conformity with the GATT was doubtful:

"If after entering a customs union, Malta were to retain essentially the same level of charges on imports from all sources as presently existed in the Maltese tariff, but redefined as revenue duties, it could [not] be said that trade was free of duties."²⁵¹

The parties to the agreement did not agree to this interpretation. They argued that Article XXIV did not contain any disciplines on revenue duties and that parties had substantial freedom in imposing such duties:

"The parties to the Agreement denied the validity of this interpretation concerning revenue duties in relation to the application of Article XXIV. There was nothing in the General Agreement to prohibit the levying of revenue duties, which indeed represented an essential source of revenue for developing economies. The freedom of action of any contracting party in the application of its fiscal policy was not limited by the General Agreement except where its direct or indirect protective effects might be detrimental to a concession. In the face of the provisions of Article XXIV, the existence of revenue duties, which by definition ruled out discriminatory application, could not be regarded as jeopardizing the establishment of free - trade."²⁵²

²⁵⁰The Working Party Report (L/3465) was adopted on 2 December 1970: see GATT, (BISD) (1972) Eighteenth Supplement, para. 7 at pp135-136.

²⁵¹The Working Party Report (L3665) was adopted on 29 May 1972: see GATT, (BISD) (1973) Nineteenth Supplement, para. 14 at p94.

²⁵²*ibid.*, para. 17 at p94.

Generally, the meaning of duties in the context of Article XXIV:8 has not generated as much controversy as the meaning of "other restrictive regulations of commerce", which is addressed next.

5.3.3.2.2 *The Meaning of "Other Restrictive Regulations of Commerce"*

The meaning of the phrase "other restrictive regulations of commerce" in Article XXIV:8 has provoked a lot of controversy. It is not clear, for example, how different it is from the phrase "other regulations of commerce" appearing in Article XXIV:5. Some Members of the WTO have argued that there is a difference between the two phrases and that the standards for evaluating them are different. In a communication to the Committee on Regional Trade Agreements, Australia sought to bring out the differences between the two phrases:

"Article XXIV does not give guidance on how the word "restrictive" should be interpreted. ... [T]here appears to be a presumption that at least some of the measures allowed under the articles listed in Article XXIV:8 should be considered restrictive when they are applied to the trade between the parties to an arrangement. The perspective in Article XXIV:5 is different. The assumption is that there is an undefined range of regulations governing the trade of the parties to an arrangement with the non-parties. These regulations must not become restrictive as a result of the formation of a free - trade area or a customs union...It would appear...that in terms of Article XXIV:8, some regulations are always restrictive, whereas under Article XXIV:5 they can become more restrictive."²⁵³

While the Australian communication sheds light on the two phrases, it is still difficult to delineate clearly the differences between them. Undoubtedly, there are some measures such as quantitative restrictions and custom user fees which may qualify as an "other regulation of commerce" under Article XXIV:5 and at the same time as an "other restrictive regulation of commerce" depending on how they are applied. In the examination of the Free - trade Agreement between Canada and the United States, the issue arose as to whether customs user fees could properly be regarded as "other regulations of commerce" within the meaning of Article XXIV:5 or as "other restrictive regulations of commerce" within the meaning of Article XXIV:8:

²⁵³See WT/REG/W/25, communication from Australia; 1 April 1998, para. 4 at p2.

"In response to a suggestion...that customs user fee should be more appropriately considered as "other restrictive regulations of commerce" that applied between the two FTA parties in terms of Article XXIV:8(b), the representative of the United States said that the customs user fee could not be qualified as "restrictive regulation of commerce" in the way it was presently applied by his country."²⁵⁴

In examinations of notified agreements, the following measures have been regarded as restrictive regulations of commerce by some Members within the meaning of Article XXIV:8.

5.3.3.2.2.1 *Regulation on Preferred Source*

In the examination of the Australia - New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), the issue arose whether or not a party to a free - trade agreement could give preferred supplier status to a partner country. In the instant case, New Zealand had granted Australia the status of preferred supplier for purchases of wheat and newsprint. It based its decision not only on traditional trade ties between the two countries and the purchases made in the past to cover shortfalls in New Zealand, but also price, quality and delivery. This concession was challenged by some members of the Working Party, who thought that it would be inconsistent with the GATT as it was discriminatory. In response, New Zealand sought to justify its measure under Article XXIV.8(b): "[a]s far as the position of Australia as preferred supplier of wheat and newsprint was concerned...Article XXIV, paragraph 8(b) applied."²⁵⁵

5.3.3.2.2.2 *Export Licensing Schemes*

In the examination of the Free - trade Agreement between Canada and the United States, the issue arose as to whether export control measures could be properly regarded as "other restrictive regulation of commerce" within the meaning of Article XXIV:8. A member of the Working Party argued that Article XXIV:8(b) did not allow

²⁵⁴GATT, BISD, Thirty-Eighth Supplement, *supra* note 108, para. 40 at p60.

²⁵⁵The Working Party Report (L/5664) was adopted on 2 October 1984: see GATT, Basic Instruments and Selected Documents (BISD) (1985) Thirty-first Supplement, para. 29 at p179.

parties to a free - trade agreement to exempt other parties from the measures taken under the exceptions provided in that article. In response the representative of Canada stated that the measure was justified under Article XXIV:8(b), as parties had an obligation to remove "other restrictive regulations of commerce" on their trade:

"Under Article XXIV:8(b) of the GATT, restrictions meeting the exceptions of Article XX could be maintained in a free - trade agreement. Export control measures were included in "other restrictive regulations of commerce" in this article...[T]he FTA merely limited the scope of the application of exceptions under Article XX by the party maintaining the restriction. Article XXIV:8(b) encouraged the elimination of duties and other restrictive regulations of commerce except as permitted under the exceptions specified in that article. It did not preclude the parties to a free - trade agreement from undertaking elimination of restrictions vis-à-vis other party to the agreement."²⁵⁶

5.3.3.2.2.3 *Quantitative Restrictions*²⁵⁷

As previously discussed, there is a view that quantitative restrictions could be regarded either as "other regulations of commerce" within the meaning of Article XXIV:5 or as "other restrictive regulations" within the meaning of Article XXIV:8. In the examination of the Free - trade Agreement between Canada and the United States, a member of the Working Party challenged the maintenance of quantitative restrictions on dairy products and poultry by the parties to the agreement: "Article XXIV:8(b) did not give parties open-ended permission to maintain open-ended permission to maintain quantitative restrictions".²⁵⁸ The representative of Canada argued that it was within the rights of parties to a free - trade agreement to maintain quantitative restrictions in certain cases: "they had considered it necessary to maintain particular programmes for such products under Article XI, a measure which was consistent with Article XXIV:8b".²⁵⁹ The basis for this statement appears to be the "exceptions clause" in the article, which envisages that parties to a free - trade agreement or customs unions can impose restrictions on each other's exports pursuant to certain articles of the General Agreement.

²⁵⁶The Working Party Report (L6927) was adopted on 12 November 1991: see GATT, (BISD) (1992) Thirty-Eighth Supplement, para. 45 at p61.

²⁵⁷See earlier discussion on quantitative restrictions in Chapter 4.

²⁵⁸GATT, (BISD), Thirty-Eighth Supplement, *supra* note 108, para. 57 at p65.

5.3.3.3 *The Exceptions Clause in Article XXIV: 8*

One of the most contentious issues which has arisen in connection with Article XXIV is the scope of the exceptions clause in paragraph 8. Two main issues have been examined by Working Parties in that context, namely whether the list of Articles appearing in Article XXIV:8 is exhaustive, and whether a party to a customs union or a free - trade area could exempt the products from other constituents members of the regional trade arrangement when it imposes trade restrictions sanctioned by the Article.

5.3.3.3.1 *Is the list of articles exhaustive?*

It has been debated for some time without any clear result whether the paragraph is exhaustive, i.e. whether other Articles of the General Agreement could be invoked by a member of a customs union or a free - trade area to restrict trade between it and other members of the arrangement. On the one hand, it could be argued that by listing the applicability of some Articles, it was the intention of the drafters to exclude others not listed. On the other hand, if that was really their intention, they could have expressly said so. As a result of the imprecise language used by the drafters, it is still unclear whether Articles XVIII, XIX and XXI of the General Agreement could be relied on by a member of a regional trading arrangement to restrict imports from other members of the arrangement. The issue was considered by a sub-group of the Committee on the "European Economic Community", which examined the compatibility of the association agreements between the EEC and the overseas territories with the provisions of Article XXIV. One of the principal issues was whether a party to a regional trade arrangement could avail itself of Article XVIII of the GATT, as it was not listed in paragraph 8. Some members of the Working Party expressed the view that the list was exhaustive and that the parties to the agreement could not rely on the provisions of Article XVIII:

"paragraph 8(b), in derogation of the rule regarding the elimination of internal obstacles, made provision for certain restrictive trade regulations authorized under certain Articles of the General Agreement; the list of these did not, however, include Article XVIII, concerning governmental assistance to economic development. The application of the customs duties and of the

²⁵⁹*ibid* .

restrictions instituted under Article XVIII did not therefore benefit from the exception for which provision was made in Article XXIV."²⁶⁰

The counter argument of the EEC was as follows:

"the Rome Treaty did not make any legal use of Article XVIII. Furthermore, the argument which had been drawn *a contrario* from the fact that Article XVIII was not one of those referred to in Article XXIV:8(b) did not take into account the fact that Article XXI was not mentioned either. It would be difficult, however, to dispute the right of contracting parties to avail themselves of that provision which related, *inter alia*, to traffic in arms, fissionable materials, etc., and *it must therefore be concluded that the list was not exhaustive.*"²⁶¹ (italics added)

In a recent case Argentina – Safeguard Measures on Imports of Footwear, the Panel seemed to be of the view that the Article was merely indicative and that other Articles of the GATT could be invoked by parties to regional trade agreements:

"Although the list of exceptions in Article XXIV:8 of GATT clearly does not include Article XIX, in our view, that paragraph itself does not necessarily prohibit the imposition of safeguard measures between the constituent territories of a customs union or free - trade area during their formation or after their completion. A frequently advanced justification for the maintenance or introduction of safeguards clauses within regional integration areas is the argument that the obligation of Article XXIV:8 to eliminate all duties and other restrictions of commerce applies only to "*substantially all*" but not necessarily to "*all*" trade between the constituent territories. It could be argued that for all practical purposes the application of safeguard measures to particular categories of like or directly competitive products is unlikely to affect a trade volume that could put the liberalisation of "*substantially all trade*" between the constituent territories of a customs union into question."²⁶² (italics in original)

The Panel, however, later qualified this statement acknowledging that in certain situations unrestrained use of safeguard measures could actually go beyond the acceptable limits under Article XXIV:

"But the persuasiveness of this argument depends mainly on the extent to which safeguard measures are actually imposed. Thus we do not exclude the possibility that extensive use of safeguard measures within regional integration

²⁶⁰The Working Party Report (L/778) was adopted on 29 November 1957: see GATT, (BISD) (1958) Sixth Supplement, para.16 at p94.

²⁶¹*Ibid*, para. 26 at p97.

²⁶²*Argentina – Safeguard Measures on Imports of Footwear*, WT/DS121/R, para. 8.97 at p157. The DSB adopted the Appellate Body Report and the Panel Report, as modified by the Appellate Body Report, on 12 January 2000.

areas for prolonged periods could run counter to the requirement to liberalise "substantially all trade" within a regional integration area. In our view, the express omission of Article XIX of GATT from the lists of exceptions in Article XXIV:8 of GATT read in combination with the requirement to eliminate all duties or other restrictions of commerce on "substantially all trade" within a customs union, leaves both options open, i.e., abolition of the possibility to impose safeguard measure between the member States of a customs union as well as the maintenance thereof."²⁶³

Given that there is no logical reason for the exclusion of certain articles such as Articles XIX and XXI, it could be argued that the list in Article XXIV:8 is merely indicative and that parties to regional trade agreements may in certain instances restrict the exports of their partner countries pursuant to other permissible GATT Articles.

5.3.3.3.2 *List of Exceptions and the Non-Discrimination Principle*

Assuming that the list of articles in paragraph 8 is merely indicative and that parties to a regional trade arrangement can impose other restrictive measures such as safeguard measures, the question has arisen whether in the application of such measures the non-discrimination principle should be observed. In other words, can parties to free - trade areas and customs unions exempt each other's exports when, for example, applying a safeguard measure.

In the examination of the EC Agreements with Finland, representatives of the EEC and Finland argued before the Working Party that "Article XXIV:8(b), specifically mentioning Article XIII, was permissive in this respect and covered certain possibilities in relation to the maintenance of outward restrictive regulations of commerce in certain

²⁶³The Panel further justified its decision by asserting that since parties are not expected to eliminate all barriers immediately, they could remove safeguard measures over a reasonable period of time: "In the alternative, even if one were to presume that the maintenance of intra-regional safeguard clauses between the member States of customs unions or free - trade areas is difficult to reconcile with the wording of Article XXIV:8 of GATT (i.e., the omission of Article XIX from the exemption list), we recall that Article XXIV of GATT does not require the immediate completion of a customs union or free - trade area with full integration of intra-regional trade and immediate compliance with all the requirements foreseen in Article XXIV of GATT. For a "reasonable period" of normally not more than ten years, interim agreements leading to the gradual formation of a customs union or a free - trade area are permissible under Article XXIV." *Ibid.* The Appellate Body confirmed the rulings of the Panel on most points: WT/DS121/AB/R, adopted together the Panel report was modified by the Appellate Body report on 12 January 2000.

circumstances, while eliminating those between the parties to the Agreement."²⁶⁴ This view was not shared by a member of the Working Party, who thought that the response "was outside the provisions of Article XXIV and outside the letter and spirit of the GATT itself."²⁶⁵

The difficulty of this issue was highlighted in a report prepared by the Industrial Council of Japan:

"There are two different views on the issue. One states that not invoking safeguards against members of the union area is a natural result of having a customs union or free - trade area. The other says that the purpose of safeguards is to protect domestic industries, and it is therefore not rational to waive them only for countries within the union or area. Safeguards should therefore be applied in conformance with the obligation to provide most-favoured-nation treatment"²⁶⁶

The Report continues that:

"One could counter the argument [that safeguards must be eliminated in free - trade areas and customs unions] with the following explanation: those articles cited as exceptions are trade restrictions which are effective by themselves. Thus actions that must be invoked to be effective (such as safeguards) are outside the scope of the explanation cited"²⁶⁷.

In a Communication to the Committee on Regional Trade Agreements, Japan also highlighted the difficulties involved in interpreting this provision. It argued that the list could not be exhaustive as it would by necessary implication mean that if a party to a customs union or a free - trade area had a genuine security threat and invoked the provisions of Article XXI, it had to exempt products originating in other members of the regional trading arrangement:

"There is a divergence of views on whether the Articles listed in the parentheses in Article XXIV:8(a)(i) (Articles XI, XII, XIII, XIV, XV and XX of the GATT) are an exhaustive list of exceptions to the requirement that restrictive regulations of commerce be eliminated. It would be difficult to interpret that the exceptions are limited only to those permitted under those Articles listed in the parentheses.

²⁶⁴The Working Party Report (L/4064) was adopted on 30 October 1974: see GATT, (BISD) (1975) Twenty-first Supplement, para.16 at p80.

²⁶⁵*ibid.*

²⁶⁶Industrial Structure Council of Japan (1994) p312.

²⁶⁷*ibid* at p318.

Such interpretation would require members of RTAs to eliminate, for example, regulations permitted under Article XXI of the GATT (the exception for national security) against other Members of the RTA, even if the regulations were essential for the national security of that Member. This interpretation would be very unrealistic. Therefore, we should examine whether there are exceptions other than those listed in the parentheses of Article XXIV:8 in light of the intents of other WTO provisions".²⁶⁸

After reaching the conclusion that the list cannot be exhaustive, Japan proceeded to examine whether safeguard measures have to be imposed regardless of the source of the product:

"Safeguard measures are considered to provide a safety valve for domestic industries against a sudden increase in imports that cause serious injury and grave economic and social costs. This function of safeguard measures should not be changed even if the imports are from members of an RTA. As safeguards are urgent and temporary measures, derogation from Article II and other provisions is allowed on an exceptional and temporary basis. If it is not necessary to apply safeguard measures against imports from members of an RTA, safeguard measures should not be applied against third countries, either. Otherwise it would create discrimination between RTA members (which do not face safeguard measures) and third countries (which face safeguards). Therefore, it should be understood that safeguard measures should be applied on a MFN basis without discrimination between RTA members and third countries, as provided for in Article 2:2 of the Agreement on Safeguards. This understanding would also apply to anti-dumping measures. If anti-dumping measures are applied ... [arbitrarily], free and non-discriminatory trade will be distorted."²⁶⁹

Whereas the Japanese argument makes sense, it cannot be disputed that the arguments advanced on each side are equally valid, making it difficult to choose one over the other. On the one hand, if we accept that it was the intention of the drafters that there should be the minimum number of restrictions on trade between the parties to a regional trade agreement, then it is logical for them to exempt each other's exports from the imposition of trade restrictive measures. On the other hand, the argument could be made that the above interpretation would patently ignore the words of the Article XXIV:8, as it expressly authorises the imposition of certain trade restrictive measures on the exports of partner countries. Put in another way, it is envisaged under

²⁶⁸WT/REG/W/29; 29 July 1998, para. 8 at p2.

²⁶⁹*ibid*, paras. 9-11 at p2.

the Article that parties would impose trade restrictions regardless of the source of the products in question.

The issue arose tangentially in the Argentina safeguards case. There, as we have seen, the Panel had to decide whether a party to a regional trade agreement could exempt the exports of its partner countries from the application of a safeguard measure when the injury analysis had been based on exports from all sources. The European Community accepted the contention of Argentina that Article XXIV prohibited it from imposing a safeguard measure on the other members of MERCOSUR:

"According to the European Communities, Article XXIV GATT permits the members of a customs union or free - trade area to decide whether, when applying a safeguard measure pursuant to Article XIX GATT and the Agreement on Safeguards, to exempt the other members of the customs union or free-trade area from the measure. This option, however, has to be carried out in a consistent manner: for example, if – as in the case in the present dispute – a member of a customs union, it should necessarily exclude intra-zone imports from the determinations on which the application of safeguard measures is based."²⁷⁰

The Panel appeared to agree with the European Union on this point. However, in the instant case, it ruled against Argentina because it had carried out its injury investigations on the basis of imports from all sources but imposed the safeguard measures only on imports from third countries. The point is that, had Argentina excluded imports from its MERCOSUR partners in its injury investigations, the level of the specific duties it imposed on imports from third countries would have been lower, assuming that the exclusion of imports from MERCOSUR countries would not have affected the finding of serious injury to its domestic industry:

"On the basis of this analysis, we conclude that a member-state-specific investigation that finds serious injury or threat thereof caused by imports from all sources cannot serve as a basis for imposing a safeguard measure on imports only from third-country sources of supply."²⁷¹

²⁷⁰*Supra* note 262, para. 5.71 at p28.

²⁷¹*Ibid* at para. 8.91 at p156.

Based on this finding, the Panel proceeded to reject Argentina's argument that it was prevented from imposing a safeguard measure on its MERCOSUR partner countries:

"We do not agree with the argument that in the case before us Argentina is prevented by Article XXIV:8 of GATT from applying safeguard measures to all sources of supply, i.e., third countries as well as other member States of MERCOSUR."²⁷²

It is highly likely that the Panel would have sided with Argentina on this point, had it not taken into account imports from its MERCOSUR partners in its injury analysis and exclude them from the application of the safeguard measure. Given the over-arching goal of the drafters of the General Agreement to ensure a high degree of liberalisation of trade between the constituent members of a free - trade area or a customs union, it would make sense to oblige them to exempt each other's exports from the application of any trade restrictive measure, unless there are issues relating to national security to be determined on an objective basis.

5.3.3.4 *The scope of Article XXIV:8(a)(ii) – are parties to customs union obliged to apply substantially the same duties and other regulations of commerce?*

Whereas there is a convergence in the views of WTO Members that parties to customs unions have to apply substantially the same duties and other restrictive regulations of commerce from the outset, there is divergence in the opinions of Members whether subsequent applicants have to adopt the same restrictive regulations of commerce upon their accession if they were not applying such restrictions.²⁷³ The issue has gained prominence due to the enlargement of the European Union to include countries such as Austria, Finland and Sweden.

²⁷²*Ibid* at para. 8.101 at p158. On appeal, the Appellate Body held that the Panel had misdirected itself as to the proper this issue in this case. Article XXIV was not relevant: "we believe that the Panel erred in deciding that an examination of Article XXIV:8 of the GATT 1994 was relevant to its analysis of whether the safeguard measures at issue in this case were consistent with the provisions of Articles 2 and 4 of the *Agreement on Safeguards*"; WT/DS121/AB/R, para. 110 at p38.

²⁷³Unlike duties, where there have to be compensation negotiations pursuant to Articles XXIV:6 and XXVIII of GATT, there is no comparable mechanism for non-tariff barriers.

The issue was recently considered by a panel in the *Turkey - Textiles* case, where following the customs union agreement between Turkey and the European Union, the former, which did not have any restrictions on textiles and clothing imports, started applying the restrictions maintained by the European Union on these products. India and a number of countries objected to the imposition of these measures, but Turkey sought to justify them on the basis of Article XXIV:8(a)(ii), which obliges parties to customs unions to apply "substantially the same duties and other regulations of commerce". Turkey argued that, since trade in textiles and clothing constituted about 40 per cent of its trade with the European Union, it was important for them to apply the same regulations, otherwise there could be massive trade diversion such as to fundamentally weaken the common commercial policy of the European Union.²⁷⁴ India challenged Turkey's assertion that Article XXIV:8(a)(ii) provided it with the legal justification to impose quantitative restrictions on India's exports of textiles and clothing products:

"[T]he obligations under Article XI:1 of GATT and Article 2.4 of the ATC were not modified by Article XXIV:8(a)(ii) of GATT, which required Members forming customs unions to apply substantially the same regulations of commerce to the trade with other Members of the WTO...The provision could not possibly be interpreted to imply that Members, in fulfilling that requirement, were entitled to ignore their WTO obligations when applying restrictions to imports from third countries. Article XXIV:4 made it clear that the purpose of a customs union was not to raise barriers to the trade of third countries, and Article XXIV:6 stipulated that tariff bindings could not simply be ignored by Members forming a customs union which, if necessary, had to renegotiate them in accordance with the procedures set out in Article XXVIII. If the obligations under Article II could not be ignored by Members forming a customs union, how could one reasonably conclude that the obligations under Article XI:1 of GATT and Article 2.4 of the ATC could be ignored."²⁷⁵

²⁷⁴ *Supra* note 111, para. 6.89 at p48.

²⁷⁵ *Ibid*, para. 6.86 at pp47-48. In its third party submission, the Philippines argued that "Turkey could not invoke (the excuse of) harmonization under Article XXIV:8(a)(ii), because the territory of Turkey and the territory of the European Communities did not constitute a genuine single customs territory, the Turkey-EC arrangement having not established the existence of a customs union between the parties, neither in relation to the required elimination of duties and other restrictive regulations of commerce or intra-trade nor the application of substantially the same duties and other regulations of commerce to the trade of third parties": *Ibid*, para. 7.74 at p86. Thailand also supported the position of India. It argued that Turkey had misinterpreted the rules and jurisprudence of the GATT/WTO: [The]...arguments [of Turkey were] factually incorrect, without a basis under the GATT, and contrary to the GATT jurisprudence. The consistency of the Treaty of Rome and the Ankara Agreement with the provisions of Article XXIV had continually been contested by contracting parties to the GATT and Members of the WTO since the initial examination of the Treaty of Rome in 1957. ...GATT jurisprudence, as reflected by a number of reports of Working Parties and of panels examining issues pertaining to Article XXIV, clearly substantiated that the provisions of Article XXIV were not the exception

After an extensive analysis of the provisions of Article XXIV, the Panel concluded that whereas in some situations, parties to a regional trade agreement could adopt inconsistent WTO measures, in this particular case Turkey had failed to prove that it was necessary for it to adopt the challenged measures:

"We note Turkey's argument that if it wants to exercise its right to form a customs union with the European Communities, it has no alternative but to adopt exactly the same external trade policy as that of the European Communities and consequently, if need be, it is authorised by the provisions of Article XXIV:8(a)(ii) to violate the prohibition of Articles XI and XIII of GATT (and Article 2.4 of the ATC). ... We note also that sub-paragraphs 8(a)(i) and 8(a)(ii) address distinct but inter-linked policies. Therefore, the inclusion of a sector within the coverage of a customs union, i.e. the removal of all trade barriers in respect of products of that sector between the constituent members of the customs union, does not necessarily imply that those constituent members must apply identical barriers or barriers having similar effects to imports of the same products from third countries. We note, however, in terms of sub-paragraph 8(a)(i) the possibility for parties to a customs union to maintain certain restrictions of commerce on their trade with each other, including quantitative restrictions ("...where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX"). This implies that even for "substantially all trade originating in the constituent territories" to be covered (here, for instance, textile and clothing products), certain WTO compatible restrictions can be maintained. This implies that internal quantitative restrictions can be used in the event that only one of the constituent territories has in place a restriction on imports from third countries. If such pre-existing import restrictions were WTO compatible, the maintenance of an internal import restriction between the two constituent territories would ensure that the protection afforded by the original WTO compatible quota would not be circumvented. The maintenance of such an internal restriction can obviate the need for identical external trade policies."²⁷⁶

On appeal, the Appellate Body confirmed the above reasoning of the Panel:

to, nor the justification or waiver for the institution or maintenance of any form of QRs": *ibid*, para. 7.84 at p88. The United States also agreed with India that Article XXIV did not provide justification for the violation of other Articles of the GATT: "Turkey's contention that its customs union with the European Communities allowed it to maintain new QRs on imports from third countries in derogation from the provisions of Article XI should be rejected. The United States also disagreed with Turkey's interpretation of Article XXIV:8(a)(ii). Article XXIV:8(a) was a definitional paragraph. It described the characteristics of a customs union, one of which was that the constituent Members applied substantially the same regulations of commerce to trade from outside the union. However, Article XXIV:8 did not require or authorize the customs union to adopt any particular set of such external regulations. Most importantly, Article XXIV:8(a)(ii) nowhere provided that the external regulations that the customs union chose to apply could be consistent with WTO requirements (Of course, if Turkey wished to act inconsistently with its WTO obligations it was always free to seek a waiver)": *ibid*, para. 7.110 -7.111 at pp94 - 95.

"We agree with the Panel that had Turkey not adopted the same quantitative restrictions that are applied by the European Communities, this would not have prevented Turkey and the European Communities from meeting the requirements of sub-paragraph 8(a)(i) of Article XXIV, and consequently from forming a customs union. We recall our conclusion that the terms of sub-paragraph 8(a)(i) offer some – though limited – flexibility to the constituent members of a customs union when liberalizing their internal trade. ...[T]here are other alternatives available to Turkey and the European Communities to prevent any possible trade diversion, while at the same time meeting the requirements of sub-paragraph 8(a)(i)."²⁷⁷

To ensure that the rights and legitimate expectations of third countries are protected, the CRTA should formally adopt the decision of the Appellate Body on this point. This would dispel the misunderstanding that parties to a customs union agreement need to have the same external tariffs and regulations of commerce. The operative words are "substantially the same duties and other regulations of commerce" are applied by the parties to the agreement. It is clear that there is no requirement that the parties apply the same external trade policy towards third countries. The Appellate Body decision makes it clear that the requirement that parties to a customs union have the same external tariffs and regulations of commerce is not absolute and that there is scope for divergence, unless the non-adoption of the same commercial policy would undermine the effective functioning of the customs union or prevent its creation.

5.4 Agreements notified pursuant to the "enabling clause"

The Decision of the CONTRACTING PARTIES on *Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries*, otherwise known as the "Enabling Clause", emerged from the Tokyo Round of Multilateral Trade Negotiations. This clause basically permits developed countries to accord differential and more favourable treatment to developing countries, without according such treatment to other Members of the WTO. In other words, it provides legal cover for, most notably, trade concessions granted to developing countries under the Generalized System of Preferences (GSP) of 25 June 1971 by waiving the provisions of Article I of GATT 1994.

²⁷⁶ *Ibid*, paras 9.141 at p134 and paras 9.149-9.150 at p136.

²⁷⁷ *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R, para. 62 at p17. The Appellate Body report together with the Panel report as modified by the Appellate Body report were adopted on 19 November 1999.

Paragraph 2(c) of the Enabling clause extends such treatment to regional or global trading arrangements entered into by developing countries for the mutual reduction or elimination of tariffs and non-tariff measures. Thus, agreements entered into between developing and developed countries fall outside the scope of the Enabling Clause. The consistency of such agreements with WTO disciplines would have to be examined under the provisions of Article XXIV of GATT 1994 or Article V of GATS, unless a waiver is obtained pursuant to the provisions of Article IX of the WTO Agreement.

Before the enactment of the Enabling Clause, developing countries invoked Part IV of the General Agreement to enter into such preferential trading

arrangements.²⁷⁸ The enactment of the Enabling Clause in November 1979 provided developing countries with a permanent legal basis for the formation of preferential trading arrangements.²⁷⁹ The members of ASEAN which had, for example, notified their preferential trading arrangement under Part IV in 1978, re-notified their agreement under the Enabling Clause.

5.4.1 *Requirements under the Enabling Clause*

Developing countries wishing to invoke the Enabling Clause to form preferential trading arrangements are required to comply with a number of conditions. The first is that the arrangement should be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties. This requirement mirrors that spelt out by paragraph 4

²⁷⁸Part IV, which deals mainly with trade and development, was added to the General Agreement in 1965, at the behest of developing countries. It established the principle of non-reciprocity in trade negotiations between developed and developing countries, and provided for special and differential measures intended to promote the trade and development of the less developed members of GATT. It has been argued by some that it does not create legally enforceable rights. In other words, its provisions are merely hortatory in character.

²⁷⁹The precursor of the Enabling Clause was the January 1979 Decision of the CONTRACTING PARTIES to adopt the Report of the Working Party on Preferential Trading Arrangements. The Decision essentially authorised, contrary to the terms of Article I of the General Agreement, the formation of preferential trading arrangements. Members who invoked this Decision to form or make modifications to an existing arrangement were required to notify the CONTRACTING PARTIES.

of Article XXIV of the General Agreement. Given the reluctance of many developed countries to challenge agreements notified pursuant to the Enabling Clause, it is unclear what this requirement really means. Could it be argued that it is merely a general statement which does not create an obligation on developing countries, or should it be interpreted as an obligation on parties to such arrangements not to raise barriers to the trade of any individual Member, whether developed or developing?

If the ruling of the Appellate Body on the scope of Article XXIV:4 in the *Turkey - Textiles* case is taken into consideration, then presumably, it could be said that the corresponding provision in the Enabling Clause does not create any obligation on developing countries entering into preferential trading arrangements. The problem with this argument is that the Enabling Clause does not contain any comparable provisions to Article XXIV:5 of the General Agreement, which according to the Appellate Body spells out the obligations to be complied with by members of a customs union or a free-trade area. Should the absence of this equivalent provision in the Enabling Clause be interpreted as meaning that there is no obligation to be complied with by developing countries entering into regional integration agreements? Crawford and Laird seem to be of the view that the Enabling Clause gives developing countries *carte blanche* when it comes to concluding regional trade agreements:

"[A Regional Trade Agreement] formed under the Enabling Clause need not cover substantially all the trade; does not require duty elimination; has no fixed timetable for implementation; and is not subject to periodic requirements. The main obligations of parties to such a RTA are to notify the agreement or its modification to the WTO Committee on Trade and Development, to furnish information deemed appropriate, and afford the opportunity for prompt consultations with respect to any difficulty or matter that may arise."²⁸⁰

While a literal interpretation of the Enabling Clause may lead one to this conclusion, it is doubtful whether the CONTRACTING PARTIES to the GATT intended to give such *carte blanche* to developing countries. When read in context, it could be argued that while the requirements for developing countries are relatively very weak, their agreements are nevertheless expected to meet a certain threshold. It is debatable whether the test would be satisfied, if evidence can be adduced to show that intra-regional trade among the participating countries has increased. What if there is

²⁸⁰Crawford and Laird (2000) p13.

also evidence that the arrangement has diverted trade from non-member countries, although it has increased intra-regional trade? All of these questions have not been addressed, but it seems quite clear that for regional trading arrangements to contribute positively to the multilateral trading system, they should create instead of divert trade. If trade is not created but merely diverted from countries which are much more competitive, then regional trading blocs would cease to be welfare-enhancing and become tools for discriminating against other Members of the WTO.

The Enabling Clause envisages that developing countries entering into preferential trading arrangements may reduce both tariffs and non-tariff barriers to the trade of partner countries. Whereas, it requires that the reduction of non-tariff barriers be done according to guidelines provided by Members, it does not contain a similar provision for the reduction of tariff barriers. As observed by the WTO Secretariat:

"Paragraph 2(c) [of the Enabling Clause] clearly treats tariffs differently from non-tariff measures, with no specific criteria set out for the mutual reduction or elimination of tariffs, while action on non-tariff barriers is to be governed by criteria or conditions that may be prescribed by the contracting parties."²⁸¹

Another additional obligation to be fulfilled by developing countries invoking the Enabling Clause to form a preferential trading arrangement is to ensure that their agreement does not impede the MFN reduction or elimination of tariff and non-tariff trade restrictions. It is quite difficult to delineate the scope of this requirement, but a literal reading would suggest that if the conditions prevailing in the participating countries are conducive, then they should not hesitate to extend the benefits to other Members of the GATT/WTO. It may be recalled that during the Kennedy and Tokyo Rounds of Trade Talks, the members of the EEC extended some of the benefits they had granted to each other on an MFN basis.

One issue upon which no agreement has been reached is whether the Enabling Clause could be relied upon to form fully fledged customs unions or free - trade areas. As noted by the WTO Secretariat:

²⁸¹WTO Secretariat (1995) p18.

"During past debates in the GATT, it had been argued on one side that the Enabling Clause was not appropriate to deal with such RTAs which took the form of either FTAs, customs unions or interim agreements, but rather Article XXIV. On the other side, it was said that trade agreements among developing countries were covered by the Enabling Clause [regardless of the provisions of the agreement]."²⁸²

The examination of the agreement establishing MERCOSUR brought this problem to the fore. At the heart of the dispute is how to define the relationship between the Enabling Clause and Article XXIV of the General agreement. According to one school of thought, the Enabling Clause provides developing countries with an alternative legal basis for the formation of regional trading arrangements. In other words, they can rely on the provisions of the Enabling Clause to form customs unions or free - trade areas. This view is disputed by the other school of thought, which argues that the Enabling Clause cannot be relied upon to form such agreements, as it only provides legal cover for the exchange of preferences covering a narrow range of products. As noted by the WTO Secretariat:

"The Enabling Clause does not contain any reference to Article XXIV, an omission which has left unclear whether the Enabling Clause applies in situations where that Article does not, or affects the terms of the application of that Article, or represents, for developing countries, a complete alternative to the Article. Indeed, views differ as to whether the Enabling Clause provides an appropriate basis for all regional arrangements among developing countries or, as some governments maintain, was not intended to cover arrangements of major significance that, up to 1979, would have been handled under Article XXIV".²⁸³

It would appear that where the agreement is entered into by medium-income and high-income developing countries, there would be pressure exerted on the countries to allow the examination of their agreement under the provisions of Article XXIV. This was the case of MECORSUR, which brings together Argentina, Brazil, Paraguay and Uruguay. The parties argued initially that since all of them were developing countries, their agreement should be examined under the provisions of the Enabling Clause as opposed to the provisions of Article XXIV. Some countries challenged this assertion

²⁸²WTO Secretariat (2000a) footnote 74 and accompanying text at p15.

²⁸³WTO Secretariat (1995) p18.

and it was eventually agreed that the standard terms of reference for the examination of agreements had to be amended. As a result, the terms of reference for the Working Party are as follows:

"To examine the Southern Common Market Agreement (MERCOSUR) in the light of the relevant provisions of the Enabling Clause and of GATT 1994, including Article XXIV, and to transmit a report and recommendations to the Committee on Trade and Development for submission to the General Council, with a copy of the report transmitted as well to the Council for Trade in Goods. The examination of the Working Party will be based on a complete notification and on written questions and answers."²⁸⁴

This precedent has not, however, been followed in subsequent cases. The Common Market for Eastern and Southern African States (COMESA) was notified by the parties to the Agreement under the Enabling Clause, yet there was no challenge as to the proper legal basis for the examination of the agreement. The implicit acceptance by the Committee on Trade and Development of the right of the COMESA member countries to notify under the Enabling Clause seems to buttress the speculation that only agreements entered into by medium and high-income developing countries may attract challenges from other Members of the WTO.

5.5 *Agreements notified pursuant to Article XXV of GATT 1994*²⁸⁵

Article XXV essentially allowed the contracting parties to the GATT to obtain a waiver from the CONTRACTING PARTIES, if they were incapable of discharging their obligations under the General Agreement. It could therefore be invoked by countries who, in breach of Article I of the General Agreement, wanted to enter into preferential trading arrangements. A waiver to enter into a regional trading arrangement

²⁸⁴ WT/COMTD/5/Rev.1; 25 October 1995. During the years of the GATT, agreements notified under the Enabling Clause were not thoroughly examined. Normally, after notifying the CTD in writing of the formation of the regional trading arrangement, one of the parties would officially introduce the agreement in the next meeting of the CTD. Any interested contracting party could ask questions or express its opinion on the agreement. There was usually no Working Party examination of agreements notified pursuant to the Enabling Clause, hence the reluctance of developing countries to allow the examination of their agreements under Article XXIV, under which Working Parties were routinely established to examine the consistency of agreements with the multilateral rules.

²⁸⁵It should be noted that the provisions of Article XXV of GATT 1994 have been superseded by the provisions of Article IX of the Marrakesh Agreement Establishing the WTO.

would typically be requested if the parties to the arrangement could not comply with the terms of Article XXIV or the Enabling Clause. In the first two decades of the GATT, a number of developed countries invoked it to form preferential trading arrangements. In 1948, France requested and obtained a waiver for a proposed customs union with Italy, which was not at that time a member of the GATT. The founding members of the European Coal and Steel Community (Belgium, Netherlands, Luxembourg, Germany, France and Italy) obtained a waiver for their agreement on free - trade in coal and steel. The limited product coverage of the agreement meant that they could not invoke Article XXIV of the General Agreement. Similarly, the United States and Canada had to obtain a waiver for their agreement on free - trade in automobiles in 1965.

However, it should be pointed out that most of the waivers that have been granted since the early years of the GATT were to permit developed countries to extend unilateral trade preferences to developing countries. Most such agreements drew inspiration from Part IV of the General Agreement which is intended to facilitate the integration of developing countries into the multilateral trading system. Examples of non-reciprocal agreements are the Lomé Convention (1975), Australian preferences to products of Papua New Guinea (1953), Canada's preferences to imports from the Caribbean Basin (1968), and the United States preferences granted to Caribbean countries under the Caribbean Basin Economic Recovery Act (1985).

A number of these agreements including the Lomé Convention have been re-notified pursuant to the provisions of Article IX of the Marrakesh Agreement establishing the WTO. Under this Article, Members wishing to seek a waiver from Article I of GATT 1994 and other articles of the GATT have to submit a request to the Ministerial Conference, which shall establish a time-period not exceeding 90 days to consider it. If a decision is not taken by consensus during the 90-day period, a decision could be taken by three fourths of the Members.

A look at the conditions imposed by Article IX. 4 of the Marrakesh Agreement suggests that it would be difficult for Members to easily obtain waivers to implement regional trade agreements that may be inconsistent with Article XXIV and the Enabling

Clause. First, the Ministerial Conference is expected to justify its decision to grant a waiver and state the terms and conditions governing the grant and the date on which it shall be terminated. Second, there is a monitoring requirement when the waiver is granted for more than one year. The Ministerial Conference is expected every year to "examine whether the exceptional circumstances justifying the waiver still exist and whether the terms and conditions attached to the waiver have been met." On the basis of this annual review, the Ministerial Conference may decide "to extend, modify or terminate the waiver." In the context of regional trade agreements, it could be expected that third countries would request information on trade flows in order to determine whether the agreement has increased trade between the parties and whether it has diverted trade from third parties.

5.6 *Agreements notified pursuant to Article V of GATS*

The counterpart of Article XXIV of GATT 1994 is Article V under the General Agreement on Trade in Services (GATS). Before the entry into force of the WTO Agreement, the services component of regional trading arrangements were not examined, given the fact that Article XXIV deals exclusively with trade in goods. Given the increasing share of services in world trade, it was thought this was a serious defect of the GATT system, as it virtually gave parties to regional trade arrangements *carte blanche* to pursue discriminatory policies in the field of services.

The provisions of Article V of the GATS mirror those of Article XXIV, although they do not utilise the expressions customs unions or free trade areas. It uses the term economic integration reflecting the fact that the GATS covers all four modes of delivery. The guiding principle is set out in Article V:4 which provides that any economic integration agreement "shall be designed to facilitate trade between the parties to the agreement and shall not in respect of any Member outside the agreement raise the overall level of barriers to trade in services within the respective sectors or subsectors compared to the level applicable prior to such an arrangement". Thus, from the view point of the WTO, economic integration agreements entered into by Members are, in principle, acceptable if the intention of the parties is to liberalise at a pace faster than they would do in the multilateral context, and not as a medium to pursue discriminatory policies.

5.6.1 *Requirements under Article V of the GATS*

With its emphasis on "respective sectors or subsectors", it is generally thought that Article V offers more protection for non-participating countries than in Article XXIV. It has been suggested that as a result of the more desegregated (i.e. sub-sectoral) focus taken in Article V, a WTO Member cannot argue - in contrast to GATT 1994 - that the average level or "general incidence" of protection has not changed, regardless of what might occur at the level of individual products (sub-sectors).²⁸⁶

Like Article XXIV, Article V of the GATS makes provision for non-participating members to be compensated, if the participants of an economic integration withdraw or modify specific market access and/or national treatment commitments. Before amending their previously negotiated concessions, the parties to the agreement are required to notify the Council for Trade in Services of their intention at least three months before implementing the proposed amendments. They will then be obliged to hold consultations with the view of compensating *any* Member whose interests would be negatively affected by proposed amendments to the concessions. This provision is broader than its equivalent under the GATT, where compensation negotiations under Article XXVIII are required to be held with countries with initial negotiating rights and those with a principal supplying interest. The effect of such a rule is to deny compensation to smaller countries whose market shares are usually minuscule. Another difference between the provisions of Article V and Article XXIV is that, under the former, it is explicitly provided in Article XXI:2(b) that "compensatory adjustments shall be made on an MFN basis". Furthermore, under Article V, there is no provision which entitles the parties to claim credit for relaxing conditions governing a particular sector or sub-sector. It should be added that the GATS allows questions relating to compensation to be submitted to binding arbitration. The other conditions are as follows:

5.6.1.1 *Substantial Sectoral Coverage*

Like Article XXIV:8, Article V:1(a) requires economic integration agreements to have "substantial sectoral coverage", which should be understood in terms of the "number of sectors, volume of trade and modes of supply". An agreement would not be consistent

with the terms of Article V, if it provides for the *a priori* exclusion of one of the modes of supply. The reason behind this rule is to prevent Members from entering into narrow discriminatory agreements, which are generally thought not to be welfare-enhancing from the view point of the multilateral trading system. Members wishing to form an economic integration must be prepared to go beyond the liberalization commitments under the GATS, if their agreement is to conform to the provisions of Article V.

Article V:1(b) underscores this point by providing that the agreement should "provide for the absence or elimination of substantially all discrimination...between or among the parties, in the sectors covered under subparagraph(a) through [the] elimination of existing discriminatory measures, *and/or* prohibition of new or more discriminatory measures". It would, however, appear that Article V:1 is limited in its terms, when a comparison is made with the provisions of Article XXIV:8 of GATT 1994, which obliges Members to eliminate duties and other regulations on substantially all trade, which on one view means that no major sector of economic activity should be excluded from the coverage of the agreement. Under the GATS, there is no such requirement, as the parties are only required to eliminate existing restrictions, or in the alternative they can maintain the existing restrictions, provided they do not introduce new ones or make the existing ones more restrictive.²⁸⁷

5.6.1.2 *Interim Agreements*

Parties to interim agreements are obliged under Article V:7(b) to submit periodic reports on the state of implementation of their agreements to the Council of Trade in Services (CTS). Unlike Article XXIV, there is no requirement that the parties should annex a plan and schedule nor an indicative time-frame, at the end of which the parties should have eliminated substantially all the restrictions they were maintaining.

5.6.1.3 *Procedural-Notification Requirement*

A reading of paragraph 7(a) of Article V requires parties to economic integration agreements to promptly notify such agreements, any enlargement or modification to the

²⁸⁶Hoekman (1995) p54.

²⁸⁷*Ibid.*

CTS. It is not clear whether the Article expects Members to notify the Agreement or proposed changes before implementation.

It should be noted that following a decision of the General Council of the WTO in February 1996, all regional trading arrangements, whether notified to the CTG, CTS or the CTD, are to be examined by the Committee on Regional Trading Arrangements (CRTA) with a view to evaluating their consistency with the relevant multilateral rules. The decision whether an agreement has to be examined by the CRTA still rests with the three principal bodies, namely the Council for Trade in Goods, Council for Trade in Services and the Committee on Trade and Development.

Chapter 6

Evaluation of the Consistency of Regional Trade Agreements

One of the most important tools at the disposal of the WTO, to ensure that regional trade agreements entered into by WTO Members comply with the relevant multilateral trade rules and support the multilateral trading system, is its examination process. WTO Members are obliged to notify every regional trade agreement they enter into promptly to the WTO Secretariat to permit an examination of the terms and conditions of the agreement. Given the proliferation of regional trade agreements in recent times and the widely varying and extensive provisions of some, it cannot be disputed that the examination process needs to be as efficient as possible, otherwise there is the real risk that some of these agreements could undermine the multilateral trading system and erode the gains which have been made over the past fifty years.

6.1 *The examination process under the GATT*

Under the GATT, regional integration agreements entered into pursuant to Article XXIV were notified to the Council for Trade in Goods ("Council").²⁸⁸ Once notified, the agreement was put on the agenda of the next meeting of the Council.²⁸⁹ The text of the agreement and any relevant information provided by the parties was circulated to all contracting parties in advance of the Council meeting. At the meeting, one of the parties to the regional trading agreement would make a statement formally introducing the agreement. At that point, any contracting party could ask for the floor and comment on the agreement offering its views on the impact of the agreement on other contracting parties which were not parties to the agreement. It was open to any interested contracting party to request the establishment of a Working Party to examine the consistency of the agreement with the requirements of Article XXIV. It was customary for such requests to be accepted by the parties to the agreement. It was rare

²⁸⁸Agreements entered into in pursuance of the Enabling Clause were notified to the Committee on Trade and Development.

²⁸⁹It is to be noted that the practice has evolved of contracting parties informing the Council orally of either the conclusion or signing of the agreement, before officially notifying the agreement in writing. Such announcements are usually made when the Council starts its discussion of the "other business" agenda item.

for a request for the establishment of a Working Party to be opposed. It was within the authority of the Chairman of the Council to request the CONTRACTING PARTIES to authorise him to establish the Working Party, draw up its terms of reference and appoint its chairperson.

The Council rarely objected to the Chairman's request, thus paving the way for the Working Party to be established. As a general rule, the membership of the Working Party was open to any interested contracting party of the GATT. The chairperson was normally appointed in consultations with contracting parties which had expressed their interest in the agreement. There were standard terms of reference which were rarely challenged.²⁹⁰

The next step in the Working Party process was for the Chairman of the Council to announce formally to the contracting parties at the next Council meeting that a chairperson had been appointed and that the terms of reference had been agreed. A date was then selected for the new constituted Working Party to begin its work.²⁹¹ Interested contracting parties were given four to six weeks to submit their questions to the parties through the GATT Secretariat. As a general rule, the parties to the regional integration agreement were expected to send their replies within six weeks of receiving the questions. This deadline was hardly respected, partly due to the complexity of the questions and the need for Geneva-based delegations to corroborate with their respective capitals.

Once the Secretariat received the replies, it consolidated the questions and answers and issued the ensuing document to the contracting parties of the GATT. This document formed the basis of the initial discussions of the Working Party. Later on in the examination process, any interested contracting party was entitled to raise any new questions or seek clarification to any issue raised or addressed before. The objective of the Working Party was to submit a report containing conclusions and recommendations

²⁹⁰The standard terms of reference read as follows: "to examine the Agreement in the light of the relevant provisions of the General Agreement."

²⁹¹Under normal circumstances, it would take a couple of months for the Working Party to start its deliberations. It took almost two years, however, for the Working party established to examine the free-trade agreement between the European Union and the Visegrad countries to meet.

to the Council. Unfortunately, the conclusions and recommendations were not very helpful to the Council. The last paragraph of the report of the Working Party on the EFTA-Turkey Free - Trade Agreement, for example, provided that “some members concluded that there were questions about the full consistency of the EFTA - Turkey Free - Trade Agreement with respect to the relevant provisions of the General Agreement, including Article XXIV, and therefore reserved their GATT rights”.

Given the inconclusive nature of the reports of the Working Parties and the decision-making process of GATT, which generally required most decisions to be taken by consensus, it was rare for the Council to require the parties to the regional integration agreement to make changes to their agreement. It usually took note of the statements made by delegations, adopted the inconclusive report of the Working Party and instructed that the agreement in question be added to the list of agreements which had to be reviewed every two years by the Council pursuant to the 1972 Decision of the CONTRACTING PARTIES.

6.2 The examination process under the WTO

The examination process under the WTO has not changed very much, although attempts have been made to streamline it. The first step taken by WTO Members was the decision to establish the Committee on Regional Trade Agreements, a standing body to replace the numerous Working Parties established on an *ad-hoc* basis to examine agreements notified to the GATT.²⁹²

The creation of the Committee had, in principle, two clear advantages:

6.2.1 Institutional improvements

²⁹²See General Council Decision establishing the Committee on Regional Trade Agreements, WT/L/127; 7 February 1996.

As noted previously, there was no coherent manner for examining regional trade agreements. Since examinations were carried out by delegates, usually at the ambassadorial level, on an *ad-hoc* basis, there were at times more than ten Working Parties sitting roughly at the same time. Apart from making it difficult for delegates to follow these meetings, there was the acute problem of finding competent people to chair the Working Parties. The creation of the CRTA obviates this problem, since it is a standing body with a Chairperson and a reasonable number of vice-Chairpersons. Pursuant to its rules of procedure, the CRTA has usually appointed four vice-persons to ensure the continuity of its work.²⁹³ Under the GATT, there was the distinct possibility of the examination process running into difficulties each time a Chairperson became unavailable to discharge his/her duties. This could happen either for personal reasons or when the Ambassador was recalled to the capital or assigned to a different country. Since it is improbable for all the five officers to be indisposed or recalled to their capitals at the same time, it is likely that there would be continuity in the work of the CRTA and there would be an orderly transfer of functions, should it become necessary for one of the five appointed officers to leave his/her post.

6.2.2 *Operational improvements*

Given the *ad-hoc* manner in which examinations were carried out, it was difficult for there to be consistency in the Working Party reports issued after the examination process. The perspectives of chairpersons and other members of the Working Party were not always the same, thus producing inconsistent and sometimes contradictory reports which offered no real guidance to countries wishing to form regional trade arrangements. As a standing body, the CRTA has the possibility of avoiding this situation and rendering consistent recommendations which would offer guidance to countries wishing to establish free-trade areas and customs unions.

²⁹³According to Rule 12, the CRTA "shall elect a Chairperson and Vice-Chairpersons as necessary from among the representatives of Members. The election shall normally take place at the first meeting of the year and shall take effect immediately. The duration of the term of the officers shall be determined in the light of the work requirements of the Committee: WT/L /150; 20 May 1996.

Conscious of the problems that plagued the GATT examination process, the General Council mandated the CRTA "to develop, as appropriate, procedures to facilitate and improve the examination process". Pursuant to this provision, the CRTA has adopted some measures and proposed others to improve the examination process. These include the following:

6.2.2.1 *Timely provision of information and WTO Standard Guidelines*

Many Members of the WTO have identified the lack of information as one of the principal problems of the examination process. In many instances, parties fail to notify their agreements until after they have been in force for some time. According to the WTO Secretariat, "of the RTAs thus far notified under Article XXIV, one third were notified between the date of signature and the date of entry into force, and half were notified after the date of entry into force. On average, the interval between the date of entry into force and the date of notification entailed a delay of five weeks."²⁹⁴

Apart from the delays related to the notification of agreements, some countries do not promptly respond to questions submitted to them by members of the WTO. To curtail the delays related to the latter, the Secretariat proposed the adoption of a standard format for information on regional trade agreements, "to facilitate and standardize the provision of initial information by parties to regional trade agreements." The proposal of the Secretariat was accepted by the CRTA, which took note of the format at its meeting of 31 July 1996. Members are not obliged to use the format when they are notifying the agreements, but the greater majority of countries use it as a guide when providing information about their agreements. This allows for consistency and greatly facilitates the examination process. It saves a lot of time, as it enables non-participating countries to focus on the essential issues.²⁹⁵

²⁹⁴WTO Secretariat, "Note on Procedures to Facilitate and Improve the Examination Process", WT/REG/W/9; 9 October 1996, footnote 2.

²⁹⁵ The Secretariat proposed four options for consideration by the Members: "(a) [t]he CRTA could follow a two-tiered approach, with information of a general nature being due for submission at an early stage, and that of a more specific nature being required at a later date - that is, at the time of the notification proper. Timing of these two submissions could be at different stages in the process of the establishment of the RTA - negotiation, signature, ratification, entry into force. The first submission could be provided between the final

The format has four sections: the first section requests basic information on the agreement including its coverage and type (whether a free-trade area or customs union), the membership and dates of signature, ratification and entry into force and data on intra and external trade. Parties are also asked to estimate whether their agreement would create or divert trade. The second section asks the parties to provide information on their import and export restrictions including duties and non-tariff barriers. They are also asked to provide information on their rules of origin, technical regulations and standards, sanitary and phytosanitary measures, contingency protection measures (safeguards, anti-dumping, subsidies and countervailing measures) and sector-specific measures. The third section requests information on accession of new members to the RTA, dispute settlement procedures, general and security exceptions, relation with other trade agreements, and institutional framework. For transparency purposes, the last section encourages the parties to provide any other relevant information to the CRTA .

6.2.2.2 Guidelines for the examination process

While the standard format is extremely useful for the reasons identified above, it cannot by itself transform the examination process and make it more fruitful. Realising that, and to further improve the examination process, the CRTA has adopted informal guidelines for the examination process itself.²⁹⁶ Like the standard format, the draft guidelines are divided into four sections: the first section requests the parties to make available the relevant treaties or agreements together with the text of the notification to the Secretariat for circulation to Members as official WTO documents. After the

negotiation and signature of the agreement, and the notification between ratification and entry into force; (b) [e]nvisage the provision of preliminary information of a general nature to inform the Committee of early developments as soon as possible; (c) [p]arties to a RTA could be required to notify only at one point in time; for instance, between ratification and entry into force of a RTA; and (d) [f]ull flexibility could be given to the parties to a RTA in deciding when to notify their agreement": see WTO Secretariat, "Note on Procedures to Facilitate and Improve the Examination Process", WT/REG/W/9; 9 October 1996 at p2.

circulation, the documents will be considered by the relevant WTO body which shall agree on the terms of reference for the examination of the notified agreement and refer the matter to the CRTA. To make it easier for Members to keep track of the documents supplied by the parties to the agreements, it has been proposed that a register of information should be maintained by the WTO Secretariat, which would be open to inspection by any Member.

The second section requests the parties to submit some initial information on their agreement for consideration by the CRTA. It was suggested in that connection that two basic documents should be supplied by the parties as official documents to be circulated to Members, namely information provided using the standard format and the compilation of the written replies to written questions submitted by interested Members. The Chairman further suggested that once an examination of an RTA has been referred to the CRTA, the Chairperson, in consultation with the parties, should establish a work programme for the examination of the individual RTA, in particular with respect to the format and timing of initial information, and the scheduling of the first examination meeting.

The third section deals with the examination of the agreement itself in accordance with the agreed terms of reference. It has been proposed that in the case of agreements notified under both the GATT (Article XXIV) and the GATS (Article V), the examination of the "goods" and "services" aspects should be dealt with back-to-back, wherever possible. Regarding the duration of the examination process, it was suggested that it was impractical to have a time-limit and that depending on the circumstances of each case, some examinations can be concluded fairly quickly, whereas others may take a longer time. To facilitate the process, it was suggested that summary minutes for CRTA deliberations as well as requested supplementary information should be made available to Members at least three weeks before the scheduled meeting of the CRTA.

²⁹⁶WT/REGW/15; 6 May 1997. The CRTA has taken note of the Guidelines.

Regarding the report of the examination, it was suggested that it should be divided into three parts. The first part would provide an overview of the agreement. It would state the main features of the agreement, when it was notified and to which body the notification was made, the parties to the agreement and the terms of reference of the examination. The second part would contain a factual record of the examination including the views and comments expressed by delegations in course of the examination. The basic documentation as well as summary minutes of deliberations would be annexed to the report. The final part would record the conclusions of the examination of the agreement in accordance with the agreed terms of reference and in the light of the relevant provisions of the WTO.

6.2.3 *Critique of the Guidelines*

Whereas the Chairman's guidelines are very useful, they fail to address the real problem which has prevented Working Parties from reaching definitive conclusions. Over the 100 Working Parties established during the years of the GATT to examine the consistency of notified agreements with Article XXIV, only one was able to return an unanimous decision.²⁹⁷ The WTO Secretariat realises the shortcomings of the guidelines, so it has been consulting delegations to examine how best the guidelines could be strengthened:

*"Experience has shown that these guidelines needed to be partially reviewed. ...[T]he rationalization of the examination exercise went beyond finalizing a few reports. It also included clearing the large backlog of examination reports in process, and efficiently dealing with a relatively greater number of agreements notified to the WTO, compared to the past. This pointed to the need for breaking the impasse on examination reports, held up for one reason or another, by adopting a practical way of addressing the backlog and reorganizing the examination procedures, so as to ensure in particular that substantive debate takes place in each round of examination of individual RTAs."*²⁹⁸ (italics added)

²⁹⁷See the customs union agreement between Czech Republic and the Slovak Republic. Considering that these two customs territories were one country, it was quite easy for a decision to be reached.

It is my view that unless the examination process is fundamentally changed, there are not going to be any concrete results and the situation that prevailed under the GATT will continue. This view is shared by Sam Laird, who notes that "[s]o far, the CRTA has achieved no better results than the GATT."²⁹⁹ The real problem is the decision-making process of the CRTA as laid down in Rule 33 of the Rules of Procedure of the CRTA.³⁰⁰ Parties to regional trade agreements cannot be expected to accept without question the opinion of other members of the CRTA that their agreement does not comply with the relevant rules of the WTO. The GATT Working Party reports almost invariably indicated that parties to regional trade agreements defended their agreements as GATT-consistent, while non-participating countries mostly had opposing views. To address this problem, it is proposed that a panel of experts be established to evaluate the consistency of an agreement with the relevant rules of the WTO.

6.2.4 Panel of Experts

To avoid the parties to the agreement from dictating the pace of the examination process and influencing its outcome, it is proposed here that the CRTA establish a panel of independent experts to carry out the examination. These experts must have a background in law and economics and should be unaffiliated with any government. Each agreement could be examined by five experts, preferably three economists and two lawyers. The role of these experts would be to undertake quantitative analyses to determine whether the agreement would create or divert trade. They would also have to examine whether the agreement in question meets the rules elaborated in Article XXIV of GATT 1994.

Once the panel completes its work, then it would transmit its report to the CRTA for adoption. One issue which arises is whether the CRTA would have to adopt the report by consensus?. On the one hand, requiring decisions to be taken by consensus would make sense given the importance Members attach to the relationship between

²⁹⁸WT/REG/W/40; 9 November 2000, paras. 11-12 at pp2-3.

²⁹⁹Laird (1999) p1192.

³⁰⁰Rule 33 of Chapter VII provides that "[w]here a decision cannot be arrived at by consensus, the matter at issue shall be referred, as appropriate, to the General Council, the Council for Trade in Goods, the Council for Trade in Services or the Committee on Trade and Development."

regionalism and multilateralism. The only drawback, however, is that the parties to the agreement could frustrate the process by refusing to join the consensus when the report is critical of their agreement. It would therefore be more prudent if they were excluded from the process of decision-making. In other words, the CRTA could adopt the report on the basis of consensus among Members which are not parties to the agreement under examination.

This proposal is not revolutionary, as it was discussed extensively by GATT contracting parties during the Uruguay Round in the context of the negotiations on dispute settlement. It was suggested by some delegations that decisions should be taken without the participation of the disputants. That proposal was, however, not accepted. The problem with this approach as far as regional trade agreements are concerned is that since most countries are likely to have a trade interest in the newly established customs union or free-trade area, especially where the constituent territories are leading trading nations such as the member states of the European Community or NAFTA, the element of bias cannot be ruled out. A look at the GATT Working Party reports seems to indicate that a substantial number of non-participating countries expressed doubts about the compatibility of the agreement under examination with the relevant multilateral rules.

To safeguard the interests of the constituent territories, it might be advisable to follow the decision-making process of the Dispute Settlement Body as far as the establishment of Panels and the adoption of Panel/Appellate Body reports are concerned. Under the Dispute Settlement Understanding, a panel would be established, or a panel report or Appellate Body report would be adopted by the Dispute Settlement Body, unless there is a consensus not to establish the Panel or adopt the Panel/Appellate Body report. In the context of the examination of regional trade agreements by the panel of experts, the report should be automatically adopted by the CRTA, unless there is a consensus among the membership of the CRTA that the report should not be adopted. This would ensure that the parties to the agreement do not frustrate the process by interpreting the requirements of the WTO subjectively. Likewise, it would ensure that non-participating countries do not interpret the relevant provisions in a flexible manner, so as to exact maximum compensation from the parties to the agreement.

Whereas this proposal may seem to go far, Members of the WTO may consent to it if they are assured that the panel of experts would carry out its functions meticulously and in a non-partisan, professional manner. It is for this reason that it is necessary to appoint persons with the requisite knowledge and experience. It should also be borne in mind that the assessment of regional trade agreements is not a one-time exercise. The impact of a particular regional trade agreement on the multilateral trading system should be continually evaluated. It is with this in mind that the CONTRACTING PARTIES required all agreements to be examined every two years to determine whether they were operating in accordance with the relevant rules of the GATT/WTO.³⁰¹

Under the current WTO rules, while parties are obliged to provide such periodic reports, it is stated clearly that the exercise "will not in any way affect the legal rights and obligations of WTO Members."³⁰² It is my view that this provision should be reversed, so that in the event of the panel of experts finding that a particular agreement has evolved in such a way as to negatively affect the interests of third countries, the parties should be required to make the necessary changes to bring the operation of their agreement in line with the provisions of the relevant WTO rules.

6.3 *Regional trade agreements and dispute settlement*

The original Article XXIV did not have any explicit provisions on dispute settlement.³⁰³ It could well be that it was the intention of the CONTRACTING

³⁰¹ See paragraph 11 of the Understanding on the Interpretation of Article XXIV.

³⁰² WTO Document entitled "Procedures on Reporting on Regional Trade Agreements; G/L286; 16 December 1998.

³⁰³ Arguably, it could be said that the terms of Article XXIII are so broad, that they covered any complaints that Members had under Article XXIV: "If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of (a) the failure of another contracting party to carry out its obligations under this Agreement, or (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or (c) the existence of any other situation, the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be

PARTIES that all regional trade agreements would be implemented only when they had been examined by the CONTRACTING PARTIES and endorsed as being consistent with the provisions of Article XXIV. This view seems to be supported by the wording of Article XXIV.7 of the GATT 1994. The delicate balance which the GATT CONTRACTING PARTIES thought they had established started to unravel with the failure of the Working Party to reach a unanimous conclusion on the consistency of the Treaty of Rome with the provisions of Article XXIV.

No legal challenges were initiated to test the assertion of the European Economic Community that their agreement fully satisfied the provisions of Article XXIV. As suggested earlier, the United States and other countries did not pursue their legal options because of geo-political considerations.³⁰⁴ An economically strong Europe was needed to counterbalance the influence of the Soviet Union. The acquiescence by GATT contracting parties of their rights was to set an unwelcome precedent, as during subsequent examinations parties to regional trade agreements strongly defended agreements which appeared to violate the provisions of Article XXIV.

The failure of the Working Parties to reach clear and conclusive results had significant implications for the parties to the agreement, as well as non-participating countries. Under Article XXIV:7, it was expected that after examination of the agreement, the CONTRACTING PARTIES would "make such reports and recommendations to contracting parties as they deem appropriate." The question which arises is what are the consequences for the inability of the CONTRACTING PARTIES to issue "such reports and recommendations"? Could it mean that the parties are entitled to legally implement their agreement, for if it had violated the provisions of Article XXIV, the CONTRACTING PARTIES would have required them to make changes before implementing the agreement? The opposing argument is that, in the absence of a clear statement by the CONTRACTING PARTIES [CRTA] that an agreement is consistent with the provisions of Article XXIV, it cannot be assumed that

concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it."

it is. Proponents of this view argue that in such a case, non-participating countries have the right to make recourse to other provisions of the GATT. These two arguments are taken in turn.

6.3.1 *Lack of recommendations - implicit acceptance of agreement?*

Parties to regional trade agreements have often construed the terms of Article XXIV:7 very narrowly. Their main contention is that if their agreements really violated the provisions of Article XXIV, the Members of the WTO exercising their powers through the CRTA, would have insisted on them making changes to their agreement. By not making such recommendations, it could be interpreted to mean that they have approved of the agreement. This argument is deficient on two grounds. First, it ignores the nature and dynamics of the decision-making process of the WTO. Since decisions are taken by consensus, it is nearly impossible for clear conclusions to be reached in view of the partisan nature of the examination process. Parties to regional trade agreements are unlikely to accept the view of non-participating countries that certain elements of their agreement are in breach of WTO rules. Second, the *a contrario* argument that failure to reach conclusions is tantamount to acceptance of the agreement is without any legal basis. It ignores the underlying reasons as to why no conclusions were reached.

In *Turkey - Restrictions on Imports of Textile and Clothing Exports*, Turkey argued since the CRTA had not made any recommendations regarding the customs union agreement between it and the European Community, the agreement could be taken to be in conformity with Article XXIV:

"Turkey considered that, though the CRTA had not yet concluded its examination of the Turkey - EC customs union, there was no indication, two and a half years after the completion of the customs union, that it would recommend

³⁰⁴ *Supra* note 99.

to the parties, under Article XXIV:7(b), that modifications be made to the Agreement. ... No country had asked for compensatory adjustment with respect to any tariff bindings that might have been affected by the Turkey - EC customs union."³⁰⁵

The panel rejected Turkey's argument relying on the earlier case of *EEC - Imports from Hong Kong*, where the EEC sought to justify its imposition of quantitative restrictions on certain products from Hong Kong on the ground that the measures had been in force for a long period of time. Not requiring it to remove those measures amounted to acceptance of the right of Members to impose such measures:

"...This proved ... that quantitative restrictions had become a general problem and had gradually come to be accepted as negotiable, and that Article XI could not and had never been considered to be a provision prohibiting residual restrictions irrespective of the circumstances specific to each case."³⁰⁶

This argument was rejected by the panel which stated that the fact that a measure has not been challenged does not necessarily mean that it has been accepted by Members of the WTO. In effect, there was no recognition of the doctrine of acquiescence in WTO law:

"With regard to Article XI...the Panel acknowledged that there exist quantitative restrictions which are maintained for other than balance-of-payments reasons. It recognized that restrictions had been in existence for a long time without Article XXIII ever having been invoked by Hong Kong in regard to the products concerned, but concluded that this did not alter the obligations which contracting parties had accepted under GATT provisions. Furthermore the Panel considered it would be erroneous to interpret the fact that a measure had not been subject to Article XXIII over a number of years, as tantamount to its tacit acceptance by contracting parties. In fact, contracting parties and in particular Hong Kong have made it clear that the discussions on quantitative restrictions which have taken place in the GATT over the years were without prejudice to the legal status of the measures or the rights and obligations of GATT contracting parties. The Panel observed that, while most of the measures had been notified to the GATT in the past, the measures on watches had not been notified."³⁰⁷

³⁰⁵ *Supra* note 111, para. 6.124 at p58.

³⁰⁶ *Ibid*, para. 9.173 at p142.

³⁰⁷ *Ibid*, para. 173 at pp142-143.

If the panel had accepted the argument of Turkey, it would have given parties to regional trade agreements *carte blanche* to implement discriminatory measures under the cover of Article XXIV. In fact, the Turkish argument that the lack of consensus should be equated with acceptance is without any textual or legal basis. It might be advisable for the CRTA to state clearly in the report of each examination that the failure to arrive at a unanimous conclusion should not be taken to mean that the examined agreement has been approved. Such a statement would clarify the legal status of such inconclusive reports thereby contributing to security and predictability.

6.3.2 *Lack of recommendations - rejection of the agreement?*

Third countries usually reject the argument that the lack of recommendations is synonymous with approval of the examined agreement by the WTO. They argue that such an argument ignores reality, in as much as the parties to the agreement would definitely know about the strong reservations of other Members. While that may be true, the language of Article XXIV:7(a) seems to indicate that it is not a requirement that after every examination, the CONTRACTING PARTIES [CRTA] should issue recommendations. It would appear from a literal reading of the terms of the Article that they would only have to issue recommendations when they are of the view that certain aspects of the agreement are not consistent with the rules of the WTO. Thus, if this line of argument is taken to its logical conclusion, then the absence of recommendations should be interpreted to mean that the CONTRACTING PARTIES are satisfied with the provisions of the regional trade agreement, hence their decision not to address any recommendations to the parties to the agreement.

While this argument may sound persuasive, it ignores one fundamental point, that is, the decision-making process of the CRTA. If the CRTA was able to take unanimous decisions, then the argument would have been very defensible. But given the paralysis in the decision-making process, which can sometimes be partly attributed

to the intransigence of the parties to the agreement, the argument loses much of its force.³⁰⁸

Non-participating countries, in my view, have a legitimate point when they assert that given the inconclusive nature of the reports, they have the right to come back to them whenever they wish. In the examination of the Accession of Greece to the European Communities, one member of the Working Party noted that:

"The discussions of the Working Party had shown a considerable amount of divergences in the interpretation of the provisions of Article XXIV which could not be bridged over to everyone's satisfaction. His delegation was of the view that the accession was not in conformity with the relevant provisions of the General Agreement, including those relating to the application and administration of quantitative restrictions. Neither the EC nor Greece were waived in any respect under the provisions of Article XI and XIII of the GATT by concluding and implementing the Act."³⁰⁹

The views just expressed were endorsed by other members of the Working Party³¹⁰, who thought that in the absence of consensus on the consistency of the agreement with the relevant multilateral rules, they were free to raise the issues of concern to them later:

"Several other members of the Working Party could not agree that the provisions of the documents concerning the accession of Greece to the European

³⁰⁸In the examination of the Accession of Greece to the European Communities, *supra* note 149, para. 54 at p188, one member of the Working Party noted that "his delegation expressed regret for this situation, not only because it showed an unwillingness to engage in a process of dialogue which would have enabled a realistic conclusion on admittedly complex issues. [A decision would] have been possible had all the parties been more cooperative in providing information, in suggesting approaches and in reacting to possible approaches which had been suggested in the Working Party."

³⁰⁹*Ibid*, para. 51 at p186.

³¹⁰One member of the Working Party pointed out that "the only conclusion that the Working Party could reach was that it had not been possible to demonstrate the conformity of the Act with the GATT. This was not surprising in view of the fact that the CONTRACTING PARTIES had never determined that the Rome Treaty establishing the EEC, the agreements providing for the enlargement of the EEC in 1972-1973 and the EC's preferential agreements were in conformity with the GATT. The EC had not been able to convince the CONTRACTING PARTIES of the legitimacy of these agreements. One could therefore hardly conclude that any further EC accession agreements could be judged to be in conformity with the GATT": *ibid* at para. 53 at p187.

Communities were in conformity with Article XXIV of the General Agreement. Some of these members held the view that certain provisions of these documents were contrary to the provisions of Articles XI and XIII of the GATT. *All these members therefore fully reserved their rights under the General Agreement following the accession of Greece to the European Communities.*" (italics added)³¹¹

If Members did not have the right to raise questions about the agreement later, the process would have been discredited, especially where their grievances had been raised during the examination process. Given that regional trade agreements evolve, it is necessary for Members at any time to be able to raise questions about the operation of any agreement.

The critical question, however, is in which forum should they raise their concerns? If they were to raise them in the CRTA³¹², no conclusive determinations would be made given its decision-making process. Conscious of that, when Members reserve their rights under the GATT, they have in mind the invocation of the dispute settlement procedures to challenge the legality of those provisions which they believed are contrary to the multilateral trade rules. This is confirmed by the Understanding on the Interpretation of Article XXIV. Paragraph 12 thereof provides:

"The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of those provisions of Article XXIV relating to customs unions, free-trade areas or interim agreements leading to the formation of a customs union or free-trade area."

The scope of this provision has been the subject of intense debate. It has been suggested that it could be relied upon to challenge the overall consistency of a regional trade agreement with the provisions of Article XXIV. Critics of this view assert that such an interpretation would not be in accord with the language of the Article and also GATT practice, which makes it clear that the dispute settlement provisions can only be

³¹¹*Ibid*, para. 60 at p190.

³¹²It should be noted that during the years of the GATT, once the Working Party handed its "inconclusive report", it was considered to have completed its work, and as such it would normally cease to exist from that date.

relied upon to challenge an aspect of the agreement which may have violated the GATT or impaired the benefits or legitimate expectations of a Member. The respective arguments and underlying reasons are examined to determine whether or not Members of the WTO should be permitted to have recourse to the WTO dispute settlement mechanism to challenge the overall consistency of regional trade agreements with the multilateral rules. Before doing that it is necessary to review the relevant jurisprudence of GATT panels which considered this issue.

6.4 *Review of GATT jurisprudence*

As previously noted, there are at least three instances where Members of the WTO may resort to the dispute settlement procedures to challenge the consistency of a regional trade agreement with the rules of the WTO. These are (i) when the CRTA has not been able to come to a unanimous conclusion and the parties implement their agreement; (ii) when the parties implement their agreement before notifying it to the WTO and subsequently fail to get approval from the CRTA; and (iii) when the agreement has been approved by the CRTA as WTO-consistent, but a Member decides to subsequently challenge its legality. The third scenario is unlikely to happen in the short-term given the decision-making process of the CRTA, which has so far prevented it from reaching any definitive conclusions on the examinations it has carried out since its establishment in 1996. Should the decision-making powers of the CRTA be strengthened, it cannot be ruled out that there could be challenges on the overall consistency of an agreement with the provisions of Article XXIV, or an aspect of the agreement.

6.4.1 *European Community – Tariff Treatment on Imports of Citrus Products from Certain Countries in the Mediterranean Region (L/5776)*

One of the first cases in which the relationship between Articles XXIII and XXIV of GATT was examined thoroughly by a panel is *European Community – Tariff Treatment on Imports of Citrus Products from Certain Countries in the Mediterranean Region*. The dispute arose following the implementation of a number of agreements between the European Community (EC) and certain Mediterranean countries, granting preferential treatment to citrus products originating from these countries. The EC justified the preferential treatment accorded these countries on the basis of Article XXIV of GATT 1947. It argued that the agreements concluded with Cyprus, Malta and Turkey were interim agreements leading to the formation of customs unions, while those concluded with Israel and Spain were interim agreements leading to the formation of free- trade areas within the meaning of Article XXIV. The non-reciprocal agreements with Algeria, Egypt, Jordan, Lebanon, Morocco and Tunisia were justified by both the provisions of Article XXIV and Part IV of GATT 1947.

The United States challenged the legal basis of the EC's claim. It argued that the EC had violated the MFN principle by not according the same preferences to U.S. citrus products and that the EC could not avail itself of the provisions of Article XXIV. It noted that the agreements did not comply with the provisions of Article XXIV:5 and 8 of GATT 1947, as several of them did not contain a definitive plan and schedule as required and did not eliminate duties and other restrictive regulations of commerce on substantially all the trade between the parties.

The European Community disputed the claim that the agreements it had concluded with the Mediterranean countries violated the provisions of Article XXIV of GATT 1947. It argued that the agreements had been implicitly approved by the GATT, as no recommendations had been made to the parties by the CONTRACTING PARTIES as envisaged in Article XXIV:7 of GATT 1947:

"Article XXIV:7(b) gave the CONTRACTING PARTIES the possibility to make recommendations to the parties of an interim agreement and, if the CONTRACTING PARTIES did so, the parties to the interim agreement had to modify it in accordance with these recommendations, or refrain from maintaining it or putting it into force. The clear implication of this rule was that if the CONTRACTING PARTIES did not recommend any modification, the parties to

the interim agreement were entitled to implement it. On none of the agreements had the CONTRACTING PARTIES made any recommendations, and the parties therefore had the right to implement them. The EEC stressed that Article XXIV:7(b) did not require a positive approval by the CONTRACTING PARTIES. For an interim agreement notified under Article XXIV:7(a) to be consistent with the General Agreement, it was sufficient that the CONTRACTING PARTIES had examined it under Article XXIV:7(b) and had refrained from recommending modifications."³¹³(emphasis in original)

The EC further justified its position by asserting that the GATT had taken a pragmatic view regarding the consistency or otherwise of regional trade agreements with the multilateral trade rules, and that the strict legal view advocated by the United States was unwarranted. Pragmatism dictated that the legal bases of these agreements could not be questioned at a later stage:

"The EEC recalled that the CONTRACTING PARTIES had never formally approved any customs union or free - trade agreement since the first such case was presented and examined in the 1950's, nor had they addressed recommendations to the parties to modify an agreement before putting it into force. In their conclusions with respect to the Treaty of Rome, the CONTRACTING PARTIES had taken the pragmatic view that "it would be more fruitful if attention could be directed to specific and practical problems, leaving aside... the questions of law and debates about compatibility with Article XXIV of the GATT" (BISD 7S/70 para. 3). They had used similar wording in their conclusions on the Stockholm Convention (BISD 9S/20). In the view of the EEC, these and other conclusions³¹⁴ clearly indicated that the CONTRACTING PARTIES had expected the Treaty of Rome and the Stockholm Convention to be implemented, notwithstanding the fact that a consensus on their compatibility with Article XXIV had not been reached, and that they had raised no objections against the implementation of these treaties. The approach applied in the case of the Treaty of Rome and the Stockholm Convention had become the leitmotif in all subsequent examinations of customs unions and free-trade areas. In almost every case it had been agreed that the parties to the agreement examined would supply further information and notify changes to the agreement and that the agreement would not affect the rights of the contracting parties not parties to them. The only meaning that could be attached to these understandings was that the entry into force of the agreements was expected and accepted by the CONTRACTING PARTIES. To examine the consistency of the agreements with Article XXIV in the context of a violation complaint under Article XXIII would run counter to the highly pragmatic attitude the CONTRACTING PARTIES had taken towards interim agreements."³¹⁵ (emphasis in original)

³¹³ L/5776; 7 February 1985; para. 3.10 at p42.

³¹⁴The EEC further cited points (c), (d), (e), and (f) of the conclusions on the Rome Treaty (BISD 7S/71) which refer to the "application" of the Treaty and of its provisions and to "the evolution of the Community". See further BISD 9S/21 for conclusions on EFTA.

These arguments were rejected by the United States which argued that the fact that Working Parties had not been able to come to unanimous conclusions did not mean that the agreements had been approved as being consistent with the multilateral trade rules:

"[I]t could not be maintained that the failure of the EEC to meet its obligations under Article I had been sanctioned by the CONTRACTING PARTIES. In no case did a working party unanimously agree that any agreement in question was compatible with the General Agreement. It was clear that the Council had been aware of the strong divergence of views within the working parties, and its adoption of the reports should be viewed from this perspective. *The failure of the CONTRACTING PARTIES to reject the agreements did not imply acceptance nor did it constitute a legal finding of GATT consistency with Article XXIV. The fact that the CONTRACTING PARTIES were aware that the EEC was going to implement the agreements could not be equated with approval. Similarly, the fact that these agreements had been in place for a number of years did not confer legitimacy.* The pragmatic attitude the CONTRACTING PARTIES had adopted in their treatment of free-trade areas and customs unions did not envisage a loss of the right to subsequently challenge the legal validity of such agreements. The implication of the decision of the CONTRACTING PARTIES with respect to the Treaty of Rome was that, while the legal issues could not be fruitfully discussed at that stage, such legal issues could be raised at a later point in time. Moreover, as the EEC had pointed out itself, the decisions on customs unions and free-trade areas had been adopted on the explicit understanding that the legal rights of contracting parties under the General Agreement would not be affected. This clearly implied that the CONTRACTING PARTIES meant the right of individual contracting parties to challenge the consistency of the agreement with the requirements of Article XXIV to remain intact.³¹⁶ (italics added)

The EEC disagreed with the United States contention that it had accepted that the rights of contracting parties remained intact and they could at a later stage challenge the legality of an agreement. From the EEC's point of view, the fundamental principle of security and predictability would be undermined, if the legality of an agreement could be brought into question long after it had been implemented:

"[The ... argument that the right to challenge on the legal issues remained intact, ...[is] clearly absurd in the case of the Treaty of Rome where a full customs union had long been completed. Even in other cases such an argument, if taken to extreme limits, would lead to total insecurity for the parties to the agreements in

³¹⁵ *Supra* note 313, para. 3.11 at pp42-43.

³¹⁶ *Ibid* at para. 3.12 at p43.

question as regards their implementation. The CONTRACTING PARTIES could scarcely have intended this result."³¹⁷

The Panel first considered the implications for the lack of a unanimous decision on the conformity of the agreements with the provisions of Article XXIV. It expressed the view that the Panel had withheld judgment on this issue, as it had neither expressed a positive or negative view. It then proceeded to examine whether the legality of an agreement could be challenged using the multilaterally agreed dispute settlement procedures. It was of the view that panels had to exercise caution and that the appropriate authority to pronounce on the legality of an agreement was the CONTRACTING PARTIES:

"In the absence of a decision by the CONTRACTING PARTIES and without prejudice to any decision CONTRACTING PARTIES might take in the future on such a matter, ... it would not be appropriate [for the Panel] to determine the conformity of an agreement with the requirements of Article XXIV on the basis of a complaint by a contracting party under Article XXIII:1(a). The Panel did not preclude that amongst the procedures available to CONTRACTING PARTIES, a panel could be established to give an advisory opinion on the conformity of an agreement or an interpretation of specific criteria under Article XXIV to assist CONTRACTING PARTIES in making findings or recommendations under Article XXIV:7(b). However, the Panel was of the view that irrespective of the procedure to be followed for this purpose, including a panel, this should be done clearly in the context of Article XXIV and not Article XXIII, as an assessment of all the duties, regulations of commerce and trade coverage as well as the interests and rights of all contracting parties were at stake in such an examination, and not just the interests and rights of one contracting party raising a complaint."³¹⁸

While rejecting the use of the dispute settlement procedures to challenge the overall consistency of an agreement with the provisions of Article XXIV, the Panel seemed to have endorsed the view that a Member could resort to the dispute settlement provisions to challenge any measure taken by the parties pursuant to their agreement:

"The CONTRACTING PARTIES have established ... *that [dispute settlement procedures] could be used to call into question "any measure" taken by the parties to the agreements; they did not mention the possibility of calling into question the agreements as a whole.* ... Furthermore, the Panel noted that in the

³¹⁷ *Ibid*

³¹⁸ *Ibid* at para. 4.15 at p.77.

reports of the working parties relating to the respective EEC agreements with Egypt, Lebanon, and Jordan, it was specified that "as regards the possibility of consultations with the contracting parties concerning the incidence of the Agreement on their trade interests, which had been mentioned by some members of the Working Party, *the spokesman for the European Communities stated that nothing prevented these countries from invoking the relevant provisions of the General Agreement, such as Articles XXII and XXIII.*"³¹⁹ (emphasis added)

6.4.2 EEC – Member States' Import Regimes for Bananas (DS32/R)

This case related to the policy applied by a number of the member states of the EEC regarding the importation of bananas. The regimes extended duty-free treatment and other benefits to bananas originating in African, Caribbean and Pacific countries, while those originating in Central and Latin American countries had higher tariffs imposed on them and were also subject to quantitative restrictions. The complaining countries (Colombia, Costa Rica, Guatemala, Nicaragua and Venezuela) argued that the regimes maintained by the EEC member states violated, *inter alia*, the most-favoured-nation clause as embodied in Article I of GATT 1947, Articles XI:1 which generally prohibits the maintenance of quantitative restrictions, and Article XIII which requires that there be no discrimination in the administration of quantitative restrictions.

The EEC rejected these allegations and argued that the banana regimes maintained by its member states were justified by Article XI:2(c), which is an exception to the prohibition contained in Article XI:1, and Article XXIV read in conjunction with Part IV of the GATT 1947. The latter argument was based on the fact that since there was a regional trade agreement between the EEC and the ACP countries, they were entitled to accord preferential treatment to each other's products notwithstanding the provisions of Article I of GATT 1947. The problem with the argument of the EEC was that the agreement between it and the ACP countries was non-reciprocal, raising doubts as to the consistency of the Lomé Convention with the provisions of Article XXIV:8, which requires that for an agreement to be consistent with the multilateral trade rules, the parties must eliminate all duties and other restrictive regulations of commerce on substantially all the trade between them.

³¹⁹*Ibid* at para 4.18 at p.78

The EEC responded to this problem by alleging that by virtue of the provisions of Part IV of the GATT 1947, developing countries were not required to give reciprocal commitments in trade negotiations:

"[T]he requirement of Article XXIV:8 ... did not apply in respect of free-trade areas between developed contracting parties and developing countries. Because of the principle of non-reciprocity set out in Part IV, the duties and other restrictive regulations of commerce in the case of such free-trade areas had to be eliminated only with respect to imports into the customs territory of the developed contracting party participating in such free-trade areas."³²⁰

The argument of the EEC is not convincing, as the non-reciprocity principle seems to be applicable only to trade negotiations undertaken under the auspices of the GATT. In other words, it has no application in bilateral agreements concluded between developed and developing countries.³²¹ The Interpretative Note to Article XXXVI.8 of the GATT 1994 makes this clear:

"It is understood that the phrase "do not expect reciprocity" means, in accordance with the objectives set forth in this Article, that the less-developed contracting parties should not be expected, in the course of trade negotiations, to make contributions which are inconsistent with their individual development, financial and trade needs, taking into consideration past trade developments."

While an argument could be made that this principle is equally applicable to bilateral agreements, the only problem is that if this interpretation is accepted it would undermine the most-favoured-nation clause as enshrined in Article I of GATT 1994. It was probably because of this realisation that a number of developed countries requested waivers in order to implement trade agreements between themselves and developing countries.

The EEC suspecting that its argument could not withstand legal scrutiny before the Panel argued that the Panel was not competent to examine the issue as to whether the Lomé Convention was consistent with the relevant multilateral trade rules:

"[T]his question [of consistency] could not be examined under the procedures of Article XXIII by which the Panel was established, because Article XXIV:7

³²⁰DS32/R, 3 June 1993, para. 364 at p80;

³²¹Kessie (1999) p89. See further Kessie (2000) p960.

provided for specific procedures for the examination of free-trade areas by the CONTRACTING PARTIES, procedures under which relevant previous agreements had in fact been examined."³²²

Relying on past adopted GATT cases which dealt with the relationship between Article XVIII:B of GATT 1947, which allows developing countries to impose, *inter alia*, quantitative restrictions to deal with balance-of-payments problems, and the *Citrus Fruits* case, the Panel held that there was no definitive conclusion on whether or not the two procedures were mutually exclusive:

[T]his issue had been discussed by the CONTRACTING PARTIES on several occasions, but they had so far not reached a definitive conclusion on it. ... It could be argued either that Article XXIII was applicable to all disputes, including those arising under Article XXIV, or that Article XXIII was not applicable to matters on which the CONTRACTING PARTIES could take decisions under the procedures of Article XXIV. ... [E]ven if the latter argument were accepted, the procedures of Article XXIV could reasonably be considered to prevail over those of Article XXIII only in cases in which the agreement for which Article XXIV was invoked was *prima facie* the type of agreement covered by this provision i.e., on the face of it capable of justification under it. If preferences granted under *any* agreement for which Article XXIV had been invoked could not be investigated under Article XXIII, any contracting party, merely by invoking Article XXIV, could deprive other contracting parties of their rights under Article XXIII."³²³ (italics in original)

The decision of the Panel on this point makes sense, otherwise Members of the WTO could abuse their obligations under Article I and enter into discriminatory preferential trade agreements, especially considering that the examination process is largely ineffective because of the consensus principle. The problem with the decision of the Panel, however, is that except in very clear cases of non-compliance, such as where the agreement only covers an insubstantial proportion of the trade between the parties or where the general incidence of tariffs and other regulations of commerce is so high after the formation of the customs union or the free-trade area, it would be difficult to make a determination that an agreement is *prima facie* consistent with the multilateral trade rules. Most of the agreements which have been notified to the GATT/WTO appear at first sight to comply with the multilateral trade rules, but their real impact is felt after a few years of implementation. In a number of cases, it has been reported that instead of creating trade, they have diverted trade from non-participating countries.

³²²*Supra* note 320, para. 364 at p80.

³²³*Ibid*, para. 367 at p81.

After reaching the above conclusion, the Panel proceeded to establish whether or not the Lomé Convention was *prima facie* consistent with the multilateral trade rules. It answered the question in the negative as, in its view, the agreement did not satisfy the terms of Article XXIV:8(b), which requires the parties to undertake reciprocal commitments:

"Article XXIV:8(b) clearly defined free-trade areas as areas in which duties and other restrictive regulations of commerce are eliminated on substantially all the trade *between* the constituent territories, not merely on the imports into one of the constituent territories. ... [T]he EEC itself considered that the preference was justified not by Article XXIV on its own, but by Article XXIV taken in combination with the provisions of Part IV of the General Agreement. ... The issue to be examined by the Panel was therefore whether Article XXIV taken in conjunction with Part IV covered agreements that provide for the liberalization of imports into only one of its parties. Part IV... was intended to create obligations for developed contracting parties *additional* to those contained in the other Parts of the General Agreement. It was not intended to permit developed contracting parties to *subtract* from those obligations, in particular not from those under Article I. ... The Panel, therefore, found that the requirements of Article XXIV were not modified by the provisions of Part IV."³²⁴ (emphasis in original)

The decision is significant in the sense that while accepting that the provisions of Article XXIV could, probably, in certain instances override the dispute settlement provisions of the WTO, the mere invocation of the Article as a defence was not sufficient, and that the responding party had to establish, *prima facie*, that the contested agreement was in conformity with the multilateral trade rules.

6.4.3 India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products, WT/DS90/R and WT/DS90/AB/R

Although this was not a case involving regional trade agreements, its examination is necessary as one of the primary questions the Panel and the Appellate Body had to determine was whether a panel could review the consistency of measures taken to safeguard balance-of-payments problems. The background to the case is quite instructive. India had consulted with other Members in the Committee, but they had not been able to come to a consensus on the time the measures should be eliminated. India had proposed a seven-year period, but the United States and other countries thought the measures could

be phased out over a shorter period. Given the general rule that all decisions should be taken by consensus, a decision could not be taken in the Committee, whereupon the United States resorted to Article XXIII of the GATT 1994 to challenge the legality of the measures adopted by India.

During the panel proceedings India challenged the jurisdiction of the Panel to review the measures that it had imposed to safeguard its balance-of-payments problems. It argued that the Panel had to defer to the Committee on Balance-of-Payments Restrictions and should not usurp its functions:

"[T]he decision of the drafters of the WTO agreements to submit the determination of the legal status of certain measures to separate procedures and bodies specifically established for that purpose furthered the objectives of the WTO. This was because issues such as the determination of the legal status of a subsidy notified as non-actionable should be made definitively and in a manner binding for all Members by a body with expertise in that field, whose decisions should not be challengeable in disputes between two Members. Similarly, the determination as to whether a free-trade area or a customs union agreement met the criteria of Article XXIV of the GATT or Article V of the GATS required a broad economic and political assessment that was best made by the representatives of the Members meeting in the Committee on Regional Trade Agreements. ...[I]t would be inappropriate for panels to conduct that evaluation, and the only two GATT panels that had been asked to examine such agreements in the light of Article XXIV had both refused to conduct such an evaluation. The decision on whether or not to approve import restrictions notified under the balance-of-payments provisions of the GATT or a time-schedule for the removal of such import restrictions was not a technical, legal matter that could reasonably be resolved through judicial fiat. The Members had agreed on provisions that assigned the task of determining the legal status of a range of politically delicate matters to specialized bodies acting under particular procedures. These provisions reflected an assessment of the WTO membership that such matters should not be decided by panels settling a dispute between two Members, and that assessment must be respected by panels."³²⁵

The Panel rejected this argument by India and held that:

"We are thus competent to review the legal status of balance-of-payments measures and the justification of these measures to the extent necessary to

³²⁴ *Ibid* at paras 369-372 at pp81-82.

³²⁵ WT/DS90/R, para. 3.76 at pp27-28. The Panel and Appellate Body reports were adopted by the DSB on 22 September 1999.

address the claims submitted to us, within the scope of our mandate under the DSU. We are aware of the fact that the BOP Committee and panels have different functions and our finding is without prejudice to the role of the Committee and the General Council in reviewing balance-of-payments measures in the context of consultations under the balance-of-payments provisions of GATT 1994. By finding that panels can review the justification of balance-of-payments measures, we do not conclude that panels can substitute themselves for the BOP Committee, making the Committee procedure redundant and depriving Members of their rights under Article XVIII:B procedures. ... It is ... clear that panels could not ignore determinations by the BOP Committee and the General Council. Moreover, our findings do not affect the right of developing country Members to invoke Article XVIII:B when they face balance-of-payments difficulties. They do not affect their right to maintain those measures in accordance with the requirements of Article XVIII:11 and the Committee procedure remains the only procedure for Members to obtain the authorisation to maintain balance-of-payments measures under certain circumstances. On the other hand, our findings also preserve the right of Members aggrieved by balance-of-payments measures to secure the protection of their rights under the WTO Agreement if the measures at issue are no longer justified under Article XVIII:B *If India's interpretation were endorsed, a mere notification by a Member under Article XVIII:B could deprive other Members of their procedural rights under the WTO dispute settlement provisions and therefore also of the effective protection of their substantive rights.* This would also be contrary to the principle expressed in Article 3.2 of the DSU, which provides that the dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system.³²⁶ (italics added)

On appeal, India argued that while panels could examine whether specific balance-of-payments restrictions are applied in a manner that is consistent with the WTO, they have no jurisdiction to determine the overall justification of measures taken pursuant to Article XVIII:B. It urged the Appellate Body in that connection to adopt a narrow interpretation of footnote 1 to the BOP Understanding. The Appellate Body rejected India's argument and affirmed the decision of the Panel on this point. It started its analysis by stating that the competence of the Panel to review all aspects of balance-of-payments restrictions should be determined in light of Article XXIII of the GATT 1994, as elaborated and applied by the DSU, and of footnote 1 to the Understanding on Balance-of-Payments Provisions.³²⁷ It concluded that:

³²⁶ *ibid*, para. 5.114 at p159.

³²⁷ The second sentence of footnote 1 to the BOP Understanding provides as follows: "The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the

"Any doubts that may have existed in the past as to whether the dispute settlement procedures under Article XXIII were available for disputes relating to balance-of-payments restrictions have been removed by the second sentence of footnote 1 to the BOP Understanding. ... [T]his provision makes it clear that the dispute settlement procedures under Article XXIII, as elaborated and applied by the DSU, are available for disputes relating to any matters concerning balance-of-payments restrictions".³²⁸

Following this finding, the Appellate Body went on to affirm the decision of the Panel that the measures being maintained by India were inconsistent with Articles XI:1 and XVIII:11 of the GATT 1994 and with Article 4.2 of the Agreement on Agriculture.

6.4.4 *Turkey - Restrictions on Imports of Textile and Clothing Products, WT/DS34/R*

As discussed above, Turkey argued that the consistency of its agreement with the provisions of Article XXIV could not be reviewed by the Panel, as the matter was still before the Committee on Regional Trade Agreements. The Panel, basing itself on the provisions of paragraph 12 of the Understanding on the Interpretation of Article XXIV, rejected Turkey's argument that it could not examine the challenged measures. It held that this provision authorised panels to examine the consistency of a measure or measures which may have been adopted by parties to a regional trade agreement:

"We understand from the wording of paragraph 12 of the WTO Understanding on Article XXIV, that panels have jurisdiction to examine "any matters 'arising from' the application of those provisions of Article XXIV". For us, this confirms that a panel can examine the WTO compatibility of one or several measures "arising from" Article XXIV types of agreement... This indicates that, although the right of WTO Members to form regional trade arrangements is "an integral part" of the set of multilateral disciplines of GATT and now WTO, the DSU procedures can be used to obtain a ruling by a panel on the WTO compatibility of any matters arising from such regional trade arrangements... [T]he term "any matters" clearly includes specific measures adopted on the occasion of the formation of a customs union or in the ambit of a customs union... [We conclude] that a panel can assess the WTO compatibility of any specific measure adopted by WTO Members at any time and we cannot find anything in the DSU, Article XXIV or the 1994 GATT Understanding on Article XXIV that would suspend or condition the right of

Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of restrictive import measures taken for balance-of-payments purposes."

³²⁸WT/DS90/AB/R; paras 87-88, pp20-21. The Appellate Body report together with the Panel report were adopted by the DSB on 22 September 1999.

Members to challenge measures adopted on the occasion of the formation of a customs union."³²⁹

Regarding the broader issue as to whether a panel could examine the overall consistency of a regional trade arrangement with the provisions of Article XXIV, the Panel held that the CRTA was properly placed to examine that issue as there were many factors which had to be taken into account, and which presumably could not be undertaken by panels:

"[W]e note that the...CRTA has been established, *inter alia*, to assess the GATT/WTO compatibility of regional trade agreements entered into by Members, *a very complex undertaking which involves consideration by the CRTA, from the economic, legal and political perspectives of different Members, of the numerous facets of a regional trade agreement in relation to the provisions of the WTO. It appears to us that the issue regarding the GATT/WTO compatibility of a customs union, as such, is generally a matter for the CRTA. ...[I]t is arguable that a customs union (or a free-trade area) as a whole would logically not be a "measure" as such, subject to challenge under the DSU*³³⁰ (emphasis added)

On appeal the Appellate Body affirmed the decision of the panel. It, however, indicated, albeit , indirectly in *obiter dicta*, that the Panel was wrong in assuming that the dispute settlement procedures of the WTO cannot be used to challenge the overall consistency of a regional trade arrangement with the provisions of Article XXIV:

"[T]he Panel...did not address the question of whether the regional trade arrangement between Turkey and the European Communities is, in fact, a "customs union" which meets the requirements of paragraphs 8(a) and 5(a) of Article XXIV. The Panel maintained that "it is arguable" that panels do not have jurisdiction to assess the overall compatibility of a customs union with the requirements of Article XXIV. We are not called upon in this appeal to address this issue, but we note in this respect our ruling in *India - Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* on the jurisdiction of panels to review the justification of balance-of-payments restrictions under Article XVIII:B of the GATT 1994...The assumption by the Panel that the agreement between Turkey and the European Communities is a "customs union" within the meaning of Article XXIV was not appealed. Therefore, the issue of whether this arrangement meets the requirements of paragraphs 8(a) and 5(a) of Article XXIV is not before us."³³¹

³²⁹ *Supra* note 111, paras. 9.50-9.51 at pp112-113.

³³⁰ *Ibid*, paras 9.52-9.53 at p113.

³³¹ WT/DS34/AB/R, para. 60 at pp16-17. The Appellate Body report together with the Panel report as modified by the Appellate Body report were adopted on 19 November 1999.

It is implicit from the language used by the Appellate Body that it is of the view that recourse can be made to the dispute settlement procedures to challenge the overall consistency of an agreement with the provisions of Article XXIV and also measures imposed by Members to safeguard their balance-of-payments problems.³³² This view of the Appellate Body has been criticised by some Members of the WTO and academics. In the run-up to the Seattle Ministerial Conference, India tabled a proposal which would have made it clear that it is "only the Committee of Balance-of-payments [which] shall have the authority to examine the overall justification of BOP measures."³³³

In a recent article, Professor Frieder Roessler, former Director of the Legal Affairs Division of the WTO, has also criticised the decision of the Appellate Body that the dispute settlement procedures could be invoked to challenge the overall consistency of regional trade agreements with the provisions of Article XXIV and also the compatibility of measures adopted by Members to safeguard their balance-of-payments position pursuant to Article XVIII:B of the GATT 1994. According to Professor Roessler, the Appellate Body should have deferred to the respective WTO political bodies or alternatively exercised judicial restraint. In arrogating to itself those extensive powers, the Appellate Body has violated key principles of international law and its own jurisprudence by interpreting widely the provisions (footnote 1 to the BOP Understanding and paragraph 12 of the Article XXIV Understanding) which it claims confer authority on panels to make those decisions:

"Whatever the correct interpretation of the terms "application of", the question remains whether the DSU assigning competence to panels can be interpreted as overriding the provisions of other agreements assigning competence to the WTO's political bodies. It is recognised in international law that "as a general rule, any body possessing jurisdictional powers has the right in the first place itself to determine the extent of its own jurisdiction". When an organ of the WTO determines its own jurisdiction, it thus exercises its right to interpret the provision of the WTO Agreement conferring authority upon it. In doing so, it must pursuant to Article 31 of the Vienna Convention on the Law of Treaties take into account not only the terms of the provision attributing powers to it, but also the context in which this provision appears. That context comprises those provisions of the WTO Agreement that attribute related powers to other bodies.

³³² Roessler (2000) 7. He notes that: "[t]his ruling [of the Appellate Body] implies that ... [it] is of the view that panels are competent to examine the overall consistency of a regional trade agreement."

³³³ See paragraph 21 of the Draft Ministerial Conference Text; JOB (99)/5865/Rev.1); 19 October 1999.

An analysis of the terms of those jurisdictional provisions may lead the WTO organ to the conclusion that not only it but also other organs could claim jurisdiction over the matter at issue. Such a conflict must be resolved in good faith in the light of the institutional structure that the framers of the WTO Agreement have set up to realise the purposes of the WTO. The principles of the interpretation of the Vienna Convention of the Law of Treaties thus suggest that the judicial organs of the WTO cannot determine their jurisdiction exclusively on the basis of the provisions of the DSU."³³⁴

Professor Roessler further argues that the ruling of the Appellate Body undermines the balance of rights and obligations of WTO Members and expressly contradicts Article 3.2 of the DSU, which provides that "[r]ecommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements." By giving undue weight to the procedural rights of complainants, the Appellate Body ignored the rights of defendants to have their measures evaluated by the appropriate WTO body:

"Article 3.2 of the DSU states the obvious, namely that the complainant's rights under the DSU cannot diminish the rights of the defendant under other WTO agreements. The procedural rights of Members under the DSU are thus clearly subsidiary to those conferred by the WTO agreements: a complainant may resort to the DSU only to enforce the obligations of the defendant under other WTO agreements, not however to diminish the rights of the defendant under those agreements. *This implies that a panel cannot determine its jurisdiction in a manner that diminishes those rights. Article 3.2 of the DSU obliges them to exercise judicial restraint whenever a WTO Member attempts to resort to the DSU for the purpose of negating another Member's procedural rights under another WTO agreement.*"³³⁵ (emphasis added)

The italicised words confirm the view previously expressed that so long as the decision-making process of the various WTO bodies including the CRTA and the BOP Committee is incapable of yielding conclusive results, there would be a strong incentive for some Members to resort to the dispute settlement procedures to challenge the legality of measures which they deem to be in conflict with the provisions of the WTO Agreement.

³³⁴Roessler (2000), *supra* note 131 at pp7-8.

³³⁵*Ibid* at p8.

The issue to be addressed, in our context, is whether it is desirable for panels to determine the consistency or otherwise of regional trade agreements with the provisions of Article XXIV.

6.5 *Should Panels decide on the overall consistency of regional trade agreements with the provisions of Article XXIV*

Until the recent decisions of the Appellate Body in *India - Quantitative Restrictions* and *Turkey - Textiles*, it was recognised by most Members of the WTO that it was only the CRTA which could evaluate the overall consistency of regional trade agreements with the provisions of Article XXIV, hence their commitment to reform the examination process so as to yield definitive results. It is quite clear that the Members never intended to assign the authority to evaluate the overall consistency of regional trade agreements to panels. If they had intended to do that, they could have expressly stated so in the Understanding on the Interpretation of Article XXIV. Furthermore, they would have not have established the CRTA in 1996 and entrusted it with the responsibility to examine regional trade agreements and determine their consistency with the provisions of Article XXIV.

It is also inconceivable that Members intended to give panels the authority to evaluate the overall consistency of regional trade agreements with the provisions of Article XXIV, as that would have meant that there would not be a coherent way of determining the consistency of agreements with the relevant multilateral trade rules. Given the proliferation of regional trade agreements and the desire of WTO Members to ensure that the relevant rules are complied with, they could not possibly have envisaged an *ad-hoc* procedure for determining such an important issue. The DSB cannot establish a panel, unless it is specifically requested to do so by a Member. Thus, if panels were to have the sole authority of determining the consistency of agreements with the relevant multilateral trade rules, then it follows that many countries would get away with implementing or maintaining inconsistent agreements unless they were challenged by other Members before a panel.

Given the importance of ensuring that regional trade agreements remain supportive of the multilateral trading system and also the need to safeguard the rights of

non-participating countries, it is improbable that Members of the WTO would have intended such an unpredictable system for evaluating agreements. The following comments by the Premier of New South Wales concerning whether it is necessary for a Bill of Rights to safeguard the fundamental rights of citizens are apposite:

"Courts operate within an adversarial process. *Matters only arise before them when there is a dispute and judgments are made on the basis of particular facts. Decisions are therefore piecemeal in nature and cannot take into account all issues relevant to determining policy.* The material before the courts is limited by rules of evidence and procedure. A court is not an appropriate forum for making these decisions."³³⁶ (italics added)

As previously noted, a panel is likely to approach the issue of consistency of a regional trade agreement with the relevant multilateral trade rules from a strictly legal perspective. It is unlikely to take into account the dynamic and static effects of the agreement. An agreement which complies with the rules of the WTO may not necessarily further the objectives of the multilateral trading system by creating trade for the benefit of third countries. As noted by the Panel in *Turkey – Restrictions on Imports of Textile and Clothing Products*, the issue of GATT/WTO compatibility of regional trade agreements is a "very complex undertaking which involves consideration by the CRTA, from the economic, legal and political perspectives of different Members, of the numerous facets of a regional trade in relation to the provisions of the WTO."

I subscribe to the view that given their very specific functions defined by their narrowly fixed terms of reference, WTO dispute settlement panels are not well placed to determine the overall consistency of regional trade agreements with the relevant multilateral trade rules. Any attempt by a panel to go beyond its stated terms of reference to consider broader issues would be viewed with suspicion by most Members of the WTO, who already think that panels and the Appellate Body have been usurping the functions of Members.

6.5.1 *Concurrent jurisdiction*

Whereas the Panel's view in the *India - Quantitative Restrictions* case, that there could be concurrent jurisdiction as far as the determination of the consistency of

³³⁶Bob Carr, "Only people - not bills - protect rights", *The Australian*, Tuesday, 9 January 2001, p17.

agreements with the relevant multilateral trade rules is concerned, is plausible, it is extremely unlikely that Members intended to have such a duopoly given the uncertainties it could produce.³³⁷ It is feasible to envisage the situation where a panel and the CRTA may come to different conclusions regarding the consistency of an agreement with the relevant multilateral trade rules. As previously noted, a panel is more likely to approach the issue of consistency of an agreement with the multilateral trade rules from a narrow perspective, while the CRTA is more likely to take into consideration broader factors such as the static and dynamic effects of the agreement, and how it would facilitate global trade for the benefit of non-participating countries.

While the Panel is correct in asserting that it would be rare for such a situation to happen, the mere possibility that it could happen does not do much to increase the confidence of Members and private business operators in the multilateral trading system.

The lack of confidence in the dispute settlement mechanism is likely to be exacerbated if the General Council or any of its subsidiary Committees were to exercise its competence and reverse the ruling of a panel or the Appellate Body on an issue which has created legitimate expectations in the private sector. The following scenario is, for example, likely to damage the confidence of private business operators in the multilateral trading system. Let us assume that a panel issues a ruling finding a regional trade agreement to be consistent with the relevant multilateral trade rules, which encourages private companies from foreign countries to invest in the new free-trade

³³⁷"It is possible that a panel and the BOP Committee could examine successively the issue of whether the same balance-of-payments measures are justified under Article XVIII:B. If there has been no decision in the BOP Committee or General Council at the time of the panel's consideration of the issue, the issue of conflict does not arise at the panel stage, which is the situation in this case. While the BOP Committee and the General Council have considered the justification of India's balance-of-payments measures at issue in this case, they made no determinations and reached no agreed conclusions. Even if this Panel were to decide that India's measures are not justified, nothing would prevent the Committee and the General Council from reaching different conclusions on the basis of new, different facts, in which case the Council could take a decision on a phase-out period under paragraph 13 of the 1994 Understanding on Balance-of-Payments Provisions. Moreover, what Members accepted in the DSB could be modified in the General Council. The discretionary competence of the General Council to waive India's obligations under Article IX of the WTO Agreement would remain unaffected. Similarly, a decision by the Panel that India's measures were justified as of November 1997 would not preclude re-examination by the BOP Committee or the General Council of India's measures in the future.": *supra* note 319 at para. 5.93 at p153.

area. If the CRTA was unable to conclusively agree on the consistency of the agreement, or was to find the agreement to be inconsistent with WTO rules, it could affect significantly the business interests of private parties, who may have no recourse to have their grievances redressed at the multilateral level.

To avoid uncertainty and to create certainty and predictability, it is recommended that the decision as to determining overall consistency should be left solely to the CRTA, which may delegate its powers to a panel of experts in accordance with the proposals made above.

Chapter 7

Conclusion

The multilateral trading system established about 50 years ago has contributed immensely to the expansion of the global economy and increased the world's prosperity. For quite some time, the growth in world trade has consistently outpaced that of world production indicating a high degree of integration among the economies of various countries. It is widely acknowledged that trade has helped a number of countries to reduce their poverty levels and to achieve sustainable growth and development. As noted by the Director-General of the WTO, Mr. Mike Moore, in a recent speech "the multilateral trading system has probably done more to boost living standards and lift people out of poverty over the past 50 years than any other government intervention. The 17-fold rise in world trade since 1950 has gone hand-in-hand with a six-fold rise in world output. This has benefited both developed and developing countries: in both, living standards have risen three-fold. Life expectancy in developing countries has risen from 41 to 62 years, infant mortality has more than halved, while the adult literacy rate is up from 40% to 70%."³³⁸

The success of the WTO and its predecessor institution, the GATT, in bringing down barriers to world trade and promoting economic growth and development could partly be attributed to the fundamental principles that underpin the multilateral trading system, particularly the non-discrimination principle. Under this principle, if a Member of the WTO gives a benefit to another country, it has to extend it unconditionally to all the Members of the WTO. Economists have debated at length on the importance of this principle in promoting efficient allocation of the world's resources and enhancing global welfare.

Notwithstanding the persuasiveness of the underlying reasons for the non-discrimination principle in international trade relations, the WTO permits its Members to form customs unions and free-trade areas under certain conditions. This was perhaps

³³⁸Speech delivered at the Ministerial Roundtable on Trade and Poverty in Least-Developed Countries, Foreign and Commonwealth Office, 19 March 2001, p3.

the recognition that countries form regional trade groupings not only for economic benefits, but also for geo-political and other reasons. By insisting on a number of conditions which have to be complied with by WTO Members, there was the clear recognition that regional trade agreements could undermine the multilateral trading system and reduce global welfare. Until now, regional trade agreements entered into by WTO Members have supported the multilateral trading system in the sense of contributing to the reduction of barriers to trade.

A number of reasons explain why the two approaches to the liberalisation of trade have remained supportive. First, the first generation agreements were quite simple in terms of the obligations that were assumed by the parties. Apart from the Treaty of Rome, which established the European Economic Community, most of the agreements did not go beyond the exchange of tariff preferences and rarely covered issues like services, investment and competition policy. Second, the membership of the first generation regional economic groupings was quite limited. There were usually entered into by neighbouring countries at almost the same level of development. Third, a number of the first generation agreements did not succeed as a result of the lack of political will. Apart from the EEC, a number of regional economic groupings failed, particularly those established in Africa, Asia and Latin America. Fourth, countries at that time did not see the bilateral or regional track as a substitute for multilateralism. In other words, they were of the view that the two approaches were complementary and one should not be pursued at the expense of the other.

The situation in contemporary times has changed dramatically raising the real prospect that instead of regional trade agreements supporting the multilateral trading system, they would undermine it and erode some of the gains that have been achieved over the last 50 years. Almost every WTO Member is a signatory to at least one regional trade agreement. Some participate in three or more regional economic groupings. Even countries such as Japan, Singapore, South Korea, New Zealand and Australia, which had traditionally been strong supporters of the multilateral trading system, are increasingly pursuing the bilateral and regional track. Some of the proposals which have been mentioned or are under negotiation would establish mega trading blocs never witnessed in the history of international trade relations. These include the proposed free-trade area between the member states of the European Union

and the members of the North American Free-Trade Area, the Free-Trade Area for the Americas, which would link the NAFTA members with countries in Central and South America and also the Caribbean with the exception of Cuba, and the Pacific Free-Trade Area which would link the economies of most APEC members, with the notable exception of Japan. There is also the possibility that the European Union may negotiate an agreement with MERCOSUR, while China, South Korea and Japan may negotiate a free-trade area with the member states of ASEAN.

There is no doubt that if these regional economic groupings are established they would have a significant impact on the multilateral trading system in terms of undermining the non-discrimination principle, especially considering that even now over 50 per cent of world trade is conducted on a preferential basis. Another factor is that most of the second generation agreements cover areas which are not regulated at the international level, including investment and competition, and generally have tighter disciplines on non-tariff barriers. While the risk is clearly there that the multilateral trading system may fragment into three trading blocs organised around the United States, the European Community and Japan, there is also the possibility that these regional trading blocs could strengthen the WTO and the multilateral trading system, if they operate in full openness and comply with WTO rules.

It is generally accepted that if a regional trade agreement complies with the rules of the WTO, it is most likely to create trade not only for the benefit of the parties to the agreement but also for third countries thereby contributing positively to the goal of freeing up world trade. As stated in paragraph 4 of Article XXIV, the main WTO provision regulating regional trade agreements, the purpose of a customs union or a free-trade area should be to "facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories." To ensure that this broad objective is met, the WTO rules require its Members to submit agreements entered into by them for a detailed examination to establish their consistency with the relevant multilateral trade rules. To date over 100 regional trade agreements have been examined by the GATT/WTO, but with the exception of one agreement, none of the examinations has been able to offer conclusive results in terms of indicating whether or not an agreement is consistent with the relevant WTO rules.

Two main reasons were identified in this thesis to explain the paralysis in the decision-making process of the WTO regarding the consistency of regional trade agreements with the relevant multilateral trade rules. The first relates to the lack of clarity in the relevant WTO rules. The language used is ambivalent making it difficult for parties to regional trade agreements to know precisely what their obligations are under the relevant WTO rules. Similarly, third parties are unsure as to what to expect from the parties to the agreement. The result has been chaotic in the sense that each Member has attempted to interpret the provisions of Article XXIV in such a way as to further its own narrow objectives. The second relates to the decision-making process of the WTO. Under the relevant rules, all decisions have to be taken by consensus, meaning that the consent of the parties to the agreement is needed in order to arrive at the conclusion that a particular agreement is not consistent with the relevant multilateral rules. Given national sensitivities and pride, it would be rare if not impossible to find countries which would readily accept the views of other countries that their agreement is not consistent with WTO rules. Likewise it cannot be expected that third countries, whose trade interests may have been negatively affected by the regional trade agreement, would be free from any prejudices when participating in the exercise to evaluate the consistency of the agreement with WTO rules.

To strengthen the WTO and to ensure that regional trade agreements continue to support the multilateral trading system, this dissertation makes a number of recommendations aimed principally at clarifying the rules of the WTO and reforming the decision-making process of the Committee on Regional Trade Agreements to make it more effective.

7.1 *Recommendations relating to the substantive rules of the WTO*

7.1.1 *Article XXIV:4*

One of the most intractable issues which has arisen in connection with the interpretation of Article XXIV is the proper scope of Article XXIV:4 and its relationship with the other provisions of the Article. On the one hand, it has been argued that the Article in and of itself creates a separate obligation which has to be complied with by the parties to the regional trade agreement. To put it differently,

parties to regional trade agreements have an obligation not to raise barriers to the trade of any WTO Member. On the other hand, it has been argued that the Article does not create any separate obligation and that it merely sets out what the broad objectives of regional trade agreements should be. That the obligations to be complied with are stated in Article XXIV:5 et seq.

The issue is important because it could potentially increase the obligations of Members wishing to form regional trade agreements depending on which interpretation is chosen. If the former is chosen, it would mean that the parties to the agreement cannot possibly increase barriers to the trade of any Member of the WTO, unless they offer compensation. If the latter interpretation is chosen, however, it would mean acceptance of the argument that Article XXIV:4 does not create a separate obligation and that in evaluating the consistency of a regional trade agreement with the relevant multilateral trade rules, a global approach should be adopted instead of considering the impact of the agreement on each and every Member of the WTO.

The issue was recently considered by the Panel and the Appellate Body in the *Turkey –Textiles* case, where both held that Article XXIV:4 did not contain operative but purposive language and that it merely stated the "overriding and pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV".³³⁹ As previously explained, it cannot be taken for granted that the issue has been resolved definitely. Given the importance WTO Members attach to this issue, it is bound to resurface, especially considering that the views of the Appellate Body are not binding on the entire membership of the WTO. However, from a practical point of view, it was recommended in this dissertation that the CRTA should formally adopt the views of the Appellate Body on this matter. It would be extremely difficult to insist that the formation of a free-trade area or a customs union should not result in an increase in the barriers facing any of the products of any of the WTO Members. A global approach is much more realistic and can adequately protect the interests of third countries, if it incorporates certain elements.

7.1.2 *Article XXIV:5*

³³⁹*Infra*, p65.

This article was intended to safeguard and promote the interests of third countries when Members of the WTO form free-trade areas and customs unions. However, it could be seen as very confusing and ambivalent exposing the very weakness of Article XXIV, which is inadequate focus on non-tariff barriers such as rules of origin and quantitative restrictions. To clarify the terms of the Article and ensure that it adequately protects the interests of third countries, this dissertation makes a number of proposals. First, it is imperative that the Committee on Regional Trade Agreements specify that the phrase "regulations of commerce" appearing in Article XXIV:5 includes quantitative restrictions and rules of origin. Such a clarification would put to rest the long running argument that these and other measures do not qualify within the meaning of Article XXIV:5.

The dissertation points out, however, that the fact that they are to be regarded as regulations of commerce does not necessarily mean that they can be introduced arbitrarily by the parties to a regional trade agreement. With regard to quantitative restrictions, it is recommended that parties to regional trade agreements should not be allowed to circumvent their other GATT obligations (Article XI) merely by invoking the provisions of Article XXIV. In this context, this dissertation urges the Committee on Regional Trade Agreement to formally endorse the views of the Appellate Body in *the Turkey – India case*, where it stated that the adoption of quantitative restrictions upon the formation of a customs union will only be allowed where it can be demonstrated by the parties to the agreement that without the imposition of those measures, it would not be possible to establish the customs union. In effect, parties to the agreement have the burden of proof if they wish to introduce measures generally prohibited under the GATT.

With regard to rules of origin, it was demonstrated in this dissertation that depending on their restrictiveness, they could be used by the parties to regional trade agreements to divert trade from more competitive third-country sources. To effectively counteract this problem, this dissertation advocates the harmonisation of preferential rules of origin. In the interim, however, it recommends that the WTO should insist on the adoption of less-distorting rules of origin by parties to free - trade agreements. It specifically recommends that since almost all WTO Members are a party to at least one

regional trade agreement, they should be obliged to adopt the least restrictive rules of origin being applied by any of the parties under another free - trade agreement. It also endorses the proposal made by Serra et al., that rules of origin applied by WTO Members which form a free-trade area should not be "more restrictive than the *status-quo ante* regional content of exports."

On the broader question of evaluating whether the general incidence of duties and regulations of commerce has become more or less restrictive following the formation of a customs union, this dissertation acknowledges that the "Understanding on the Interpretation of Article XXIV" clarified certain matters such as making it clear that it is the applied rate of duty which has to be taken into account when carrying out the evaluation. However, it points out the limitations of the clarifications provided by the Understanding. To ensure that the rights of third countries are adequately protected, it is suggested that parties to regional trade agreements should be obliged to extend their preferences to all Members of the WTO within a ten-year period. It is, however, conceded that it would be difficult to get Members of the WTO to agree to this suggestion as there could be an enormous political backlash. As an alternative, it was proposed that parties to customs unions should be required to adopt the lowest MFN tariff on every product which was being applied by any of the parties to the regional trading arrangement prior to the formation of the union. Parties to free-trade areas could be required to narrow the differences between the tariffs being applied by them on a particular product using the lowest MFN tariff being applied by one of them as a benchmark.

Regarding the issue of a transitional period for the formation of free-trade areas and customs unions, while the "Understanding on the Interpretation of Article XXIV" made a good attempt at resolving this issue, the language used is very loose making it likely to be abused by Members. It was suggested in that connection that it would be preferable if the conditions under which Members could obtain an extension of the time period were specified.

7.1.3 *Article XXIV:6*

Regarding the interpretative problems which have been experienced in the past with the provisions of Article XXIV:6, the "Understanding on the Interpretation of Article XXIV" has resolved almost all of these issues. One of the remaining problems is how to calculate compensation in respect of increased non-tariff barriers upon the formation of a regional trading arrangement.³⁴⁰ "The Understanding on the Interpretation of Article XXIV" pertinently notes that "for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows may be required".

7.1.4 *Article XXIV:7*

This Article remains one of the most abused provisions of the GATT. Members of the WTO which enter into regional trade agreements are required to notify their agreements to the Committee on Regional Trade Agreements before implementing them. In practice, however, most Members implement their agreements before notifying them to the Committee. The purpose of requiring prior notification was to give the Committee the opportunity to conduct a quick examination to determine whether the agreement would create trade between the parties, without raising barriers to the trade of third countries. This dissertation adduces a number of reasons why Members of the WTO have neglected to comply the provisions of this Article. It stresses that unless the decision-making process of the Committee is fundamentally reformed to enable it to arrive at unanimous decisions, Members will continue to flagrantly ignore the provisions of this Article. Incentives should be created to convince Members that it is necessary for an examination to be conducted before an agreement is implemented.

7.1.5 *Article XXIV:8*

³⁴⁰Crawford and Laird (2000) p15.

This Article is one of the most important and controversial provisions of Article XXIV. To many commentators, it holds the key to ensuring that regional trade agreements operate in support of the multilateral trading system. It is generally accepted that if a regional trade agreement complies with this provision, it is more likely to create trade not only for the benefit of the parties to the agreement, but also for third countries. The principal source of disagreement about this Article is how to interpret the phrase "substantially all the trade". Two schools of thought have emerged on this issue, namely the quantitative school and the qualitative school of thought. According to the former, parties to a regional trade agreement would meet the test, if a substantial volume of their trade is liberalised. Thus, the parties are not required to liberalise all their trade, otherwise the word "substantial" would be deprived of its meaning. The qualitative school of thought holds the view that no major sector of economic activity could be excluded from the coverage of the agreement. Therefore, if an agreement excludes agriculture or textile and clothing products, that agreement would not meet the "substantial all the trade test".

After reviewing the possible rationale for inserting the "substantially all the trade" requirement into Article XXIV:8 and considering the need for regional trade agreements to complement the multilateral trading system, this dissertation took the view that parties to regional trade agreements should be made to comply with a higher threshold. It was suggested in that connection that the Committee on Regional Trade Agreements should approve the Australian proposal which would require the parties to liberalise at least 95 per cent of their trade, or require the parties to liberalise all their trade.

On the issue as to whether the list of exceptions in the Article is exhaustive, it was argued that it was not and that there are other Articles such as Article XIX and Article XXI of the GATT 1994 which could be relied upon by parties to regional trade agreements to restrict each other's trade, provided the conditions specified in these Articles are complied with. On the related question as to whether the imposition of such measures should be on a MFN basis, the dissertation reviewed the arguments which have been advanced by both sides and concluded that while both were persuasive, it would be more consistent with the spirit of Article XXIV, if parties to regional trade agreements excluded imports of their partner countries from the

application of these trade-restrictive measures. This view was implicitly shared by the Panel in the *Argentina safeguards* case, where it indicated that had Argentina based its safeguard measures on the basis of the injury analysis covering only imports from third countries, its measures could probably not have been impugned.

7.1.6 *The examination process, regional trade agreements and dispute settlement*

To improve the examination process and ensure that the Committee on Regional Trade Agreements is able to take positive decisions regarding the consistency of regional trade agreements with the relevant multilateral trade rules, it was recommended that the consensus principle should be eliminated as it is virtually impossible to get the parties to an agreement to agree with the conclusion of other Members that their agreement is not consistent with WTO rules. It was suggested in that connection that the Committee on Regional Trade Agreements should delegate its powers to a panel of experts to be composed of distinguished economists and lawyers who shall be unaffiliated with any government. In other words, they should be able to act independently and avoid any potential conflict of interest. The conclusions of this panel should be adopted by the Committee, unless there is a consensus not to adopt it. The point was made that since regional trade agreements evolve, it is necessary to monitor them regularly. In that context, it was suggested that the biennial reporting requirement should be strengthened, so that the Committee could, on the basis of the new information submitted, demand that the parties amend certain provisions of their agreement or practices.

It was noted that in the wake of the Appellate Body's decision in the *Turkey – Textiles* case, the issue has arisen whether the judicial organs of the WTO have the competence to pronounce on the overall consistency of regional trade agreements with the relevant multilateral trade rules. It was opined that frustration with the examination process had provided the impetus for Members to turn to the dispute settlement process to challenge the overall consistency of regional trade agreements with the relevant multilateral trade rules. It was argued, that given the nature of regional trade agreements, it was not appropriate to allow their overall consistency to be determined by panels and the Appellate Body, as these were likely to approach the issue from a

strict legal point of view not taking into account the dynamic effects of regional trade agreements. It was argued that unless the examination process is revamped to enable the Committee on Regional Trade Agreements to take decision, there would always be the incentive for Members to use the dispute settlement process.

7.1.7 Final Thoughts

The rate at which regional trade agreements are proliferating is alarming. For the first time since the creation of the multilateral trading system in 1948, there is the real risk that bilateralism and regionalism may become the dominant force in international trade relations. Under pressure from their corporations and other interest groups, all the leading trading nations are rushing to conclude regional trade agreements to secure market access for their goods and services, while at the same time professing their commitment to the multilateral trading system. While the two are not mutually exclusive and, in fact, could even be complementary, the timing of these initiatives puts into doubt their avowed commitment to the multilateral trading system.

After the Seattle debacle in 1999 and the negative publicity the WTO has received since then, it cannot be doubted that it is necessary for WTO Members to signal their commitment to the multilateral trading system by taking effective steps to strengthen it and conveying to the wider public the benefits to the global economy of having a non-discriminatory, rules-based multilateral trading system. The most obvious and helpful signal would be to agree to the launch of a new round of trade negotiations in Doha, Qatar in November 2001. While some Members have stated their support for such a round, a number of developed and developing countries are undecided.

Regional trade agreements could have a positive influence on the multilateral trading system, provided they operate in full openness and comply with the rules of the WTO. While the current rules of the WTO are helpful, they are not adequate and need to be strengthened so as to ensure that it is able to effectively regulate the operation of such agreements. Notwithstanding the important contribution which could be made by regional trading arrangements, they can never be a substitute for the multilateral trading system. WTO Members should realise this basic fact and invest the necessary political capital in multilateralism.

ANNEXES

THE PROVISIONS OF ARTICLE XXIV OF THE GATT 1994

ARTICLE XXIV OF GATT 1994 - Territorial Application - Frontier Traffic - Customs Unions and Free-trade Areas

1. The provisions of this Agreement shall apply to the metropolitan customs territories of the contracting parties and to any other customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application. Each such customs territory shall, exclusively for the purposes of the territorial application of this Agreement, be treated as though it were a contracting party; Provided that the provisions of this paragraph shall not be construed to create any rights or obligations as between two or more customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application by a single contracting party.
2. For the purposes of this Agreement a customs territory shall be understood to mean any territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territory with other territories.
3. The provisions of this Agreement shall not be construed to prevent:
 - (a) Advantages accorded by any contracting party to adjacent countries in order to facilitate frontier traffic;
 - (b) Advantages accorded to the trade with the Free Territory of Trieste by countries contiguous to that territory, provided that such advantages are not in conflict with the Treaties of Peace arising out of the Second World War.
4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.
5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; Provided that:
 - (a) with respect to a customs union, or an interim agreement leading to the formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;
 - (b) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade

area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement, as the case may be; and

(c) any interim agreement referred to in sub-paragraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

6. If, in fulfilling the requirements of sub-paragraph 5 (a), a contracting party proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reductions brought about in the corresponding duty of the other constituents of the union.

7. (a) Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the CONTRACTING PARTIES and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

(b) If, after having studied the plan and schedule included in an interim agreement referred to in paragraph 5 in consultation with the parties to that agreement and taking due account of the information made available in accordance with the provisions of sub-paragraph (a), the CONTRACTING PARTIES find that such agreement is not likely to result in the formation of a customs union or of a free-trade area within the period contemplated by the parties to the agreement or that such period is not a reasonable one, the CONTRACTING PARTIES shall make recommendations to the parties to the agreement. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.

(c) Any substantial change in the plan or schedule referred to in paragraph 5 (c) shall be communicated to the CONTRACTING PARTIES, which may request the contracting parties concerned to consult with them if the change seems likely to jeopardize or delay unduly the formation of the customs union or of the free-trade area.

8. For the purposes of this Agreement:

(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

(i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,

(ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;

(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are

eliminated on substantially all the trade between the constituent territories in products originating in such territories.

9. The preferences referred to in paragraph 2 of Article I shall not be affected by the formation of a customs union or of a free-trade area but may be eliminated or adjusted by means of negotiations with contracting parties affected.* This procedure of negotiations with affected contracting parties shall, in particular, apply to the elimination of preferences required to conform with the provisions of paragraph 8 (a) (i) and paragraph 8 (b).

10. The CONTRACTING PARTIES may by a two-thirds majority approve proposals which do not fully comply with the requirements of paragraphs 5 to 9 inclusive, provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article.

11. Taking into account the exceptional circumstances arising out of the establishment of India and Pakistan as independent States and recognizing the fact that they have long constituted an economic unit, the contracting parties agree that the provisions of this Agreement shall not prevent the two countries from entering into special arrangements with respect to the trade between them, pending the establishment of their mutual trade relations on a definitive basis.*

12. Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory.

**THE PROVISIONS OF THE UNDERSTANDING ON THE INTERPRETATION
OF ARTICLE XXIV OF THE GATT 1994**

Members,

Having regard to the provisions of Article XXIV of GATT 1994;

Recognizing that customs unions and free trade areas have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade;

Recognizing the contribution to the expansion of world trade that may be made by closer integration between the economies of the parties to such agreements;

Recognizing also that such contribution is increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded;

Reaffirming that the purpose of such agreements should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other Members with such territories; and that in their formation or enlargement the parties to them should to the greatest possible extent avoid creating adverse effects on the trade of other Members;

Convinced also of the need to reinforce the effectiveness of the role of the Council for Trade in Goods in reviewing agreements notified under Article XXIV, by clarifying the criteria and procedures for the assessment of new or enlarged agreements, and improving the transparency of all Article XXIV agreements;

Recognizing the need for a common understanding of the obligations of Members under paragraph 12 of Article XXIV;

Hereby *agree* as follows:

1. Customs unions, free-trade areas, and interim agreements leading to the formation of a customs union or free-trade area, to be consistent with Article XXIV, must satisfy, *inter alia*, the provisions of paragraphs 5, 6, 7 and 8 of that Article.

Article XXIV:5

2. The evaluation under paragraph 5(a) of Article XXIV of the general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union shall in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected. This assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin. The Secretariat shall compute the weighted average tariff rates and customs duties collected in accordance with the methodology used in the assessment of tariff offers in the Uruguay Round of Multilateral Trade Negotiations.

For this purpose, the duties and charges to be taken into consideration shall be the applied rates of duty. It is recognized that for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required.

3. The "reasonable length of time" referred to in paragraph 5(c) of Article XXIV should exceed 10 years only in exceptional cases. In cases where Members parties to an interim agreement believe that 10 years would be insufficient they shall provide a full explanation to the Council for Trade in Goods of the need for a longer period.

Article XXIV:6

4. Paragraph 6 of Article XXIV establishes the procedure to be followed when a Member forming a customs union proposes to increase a bound rate of duty. In this regard Members reaffirm that the procedure set forth in Article XXVIII, as elaborated in the guidelines adopted on 10 November 1980 (BISD 27S/26-28) and in the Understanding on the Interpretation of Article XXVIII of GATT 1994, must be commenced before tariff concessions are modified or withdrawn upon the formation of a customs union or an interim agreement leading to the formation of a customs union.

5. These negotiations will be entered into in good faith with a view to achieving mutually satisfactory compensatory adjustment. In such negotiations, as required by paragraph 6 of Article XXIV, due account shall be taken of reductions of duties on the same tariff line made by other constituents of the customs union upon its formation. Should such reductions not be sufficient to provide the necessary compensatory adjustment, the customs union would offer compensation, which may take the form of reductions of duties on other tariff lines. Such an offer shall be taken into consideration by the Members having negotiating rights in the binding being modified or withdrawn. Should the compensatory adjustment remain unacceptable, negotiations should be continued. Where, despite such efforts, agreement in negotiations on compensatory adjustment under Article XXVIII as elaborated by the Understanding on the Interpretation of Article XXVIII of GATT 1994 cannot be reached within a reasonable period from the initiation of negotiations, the customs union shall, nevertheless, be free to modify or withdraw the concessions; affected Members shall then be free to withdraw substantially equivalent concessions in accordance with Article XXVIII.

6. GATT 1994 imposes no obligation on Members benefiting from a reduction of duties consequent upon the formation of a customs union, or an interim agreement leading to the formation of a customs union, to provide compensatory adjustment to its constituents.

Review of Customs Unions and Free-Trade Areas

7. All notifications made under paragraph 7(a) of Article XXIV shall be examined by a working party in the light of the relevant provisions of GATT 1994 and of paragraph 1 of this Understanding. The working party shall submit a report to the Council for Trade in Goods on its findings in this regard. The Council for Trade in Goods may make such recommendations to Members as it deems appropriate.

8. In regard to interim agreements, the working party may in its report make appropriate recommendations on the proposed time-frame and on measures required to complete the formation of the customs union or free-trade area. It may if necessary provide for further review of the agreement.

9. Members parties to an interim agreement shall notify substantial changes in the plan and schedule included in that agreement to the Council for Trade in Goods and, if so requested, the Council shall examine the changes.

10. Should an interim agreement notified under paragraph 7(a) of Article XXIV not include a plan and schedule, contrary to paragraph 5(c) of Article XXIV, the working party shall in its report recommend such a plan and schedule. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations. Provision shall be made for subsequent review of the implementation of the recommendations.

11. Customs unions and constituents of free-trade areas shall report periodically to the Council for Trade in Goods, as envisaged by the CONTRACTING PARTIES to GATT 1947 in their instruction to the GATT 1947 Council concerning reports on regional agreements (BISD 18S/38), on the operation of the relevant agreement. Any significant changes and/or developments in the agreements should be reported as they occur.

Dispute Settlement

12. The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of those provisions of Article XXIV relating to customs unions, free-trade areas or interim agreements leading to the formation of a customs union or free-trade area.

Article XXIV:12

13. Each Member is fully responsible under GATT 1994 for the observance of all provisions of GATT 1994, and shall take such reasonable measures as may be available to it to ensure such observance by regional and local governments and authorities within its territory.

14. The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked in respect of measures affecting its observance taken by regional or local governments or authorities within the territory of a Member. When the Dispute Settlement Body has ruled that a provision of GATT 1994 has not been observed, the responsible Member shall take such reasonable measures as may be available to it to ensure its observance. The provisions relating to compensation and suspension of concessions or other obligations apply in cases where it has not been possible to secure such observance.

15. Each Member undertakes to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representations made by another

Member concerning measures affecting the operation of GATT 1994 taken within the territory of the former.

**REGIONAL TRADE AGREEMENTS CURRENTLY IN FORCE AND THOSE
UNDER NEGOTIATION - Source: WTO, 2001.**

	RTA	Signatories	region	status
1	Andean Community- Brazil	Brazil, Bolivia, Colombia, Ecuador, Peru, Venezuela	Americas	In Force
2	Andean Community – Argentina	Argentina, Bolivia, Colombia, Ecuador, Peru, Venezuela	Americas	In Force
3	Andean Pact	Bolivia, Colombia, Ecuador, Peru, Venezuela	Americas	In Force
4	Bolivia - Mexico	Bolivia and Mexico.	Americas	In force
5	CACM – Dominican Republic	CACM (Costa Rica, Honduras, Nicaragua, Guatemala and El Salvador) and the Dominican Republic	Americas	In force
6	Canada - Chile	Canada, Chile	Americas	In Force
7	CARICOM	Antigua and Barbuda, Bahamas (1983), Barbados, Belize, Dominica, Grenada, Guyana, Haiti (1997), Jamaica, Montserrat, Trinidad and Tobago, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname (1995)	Americas	In force
8	CARICOM-Cuba	Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, San Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago and Cuba	Americas	In force
9	CARICOM - Dominican Republic	The CARICOM Community (Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, San Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago) and the Dominican Republic	Americas	In force
10	Central American Common Market (CACM)	Costa Rica (1962), El Salvador, Guatemala, Honduras, Nicaragua	Americas	In Force
11	Chile – Colombia	Chile, Colombia	Americas	In force
12	Chile – Ecuador	Chile, Ecuador	Americas	In force
13	Chile – MERCOSUR	Chile, Brazil, Argentina, Paraguay, Uruguay	Americas	In force
14	Chile – Mexico	Chile, Mexico	Americas	In force
15	Chile – Peru	Chile and Peru	Americas	In force

16	El Salvador – Guatemala	El Salvador and Guatemala.	Americas	In force
17	MERCOSUR	Argentina, Brazil, Paraguay, Uruguay	Americas	In Force
18	MERCOSUR – Bolivia	MERCOSUR (Brazil, Argentina, Uruguay and Paraguay) and Bolivia	Americas	In force
19	Mexico - Costa Rica	Mexico and Costa Rica.	Americas	In force
20	Mexico – Nicaragua	Mexico and Nicaragua	Americas	In force
21	NAFTA	Canada, Mexico, the United States	Americas	In force
22	ANDEAN COMMUNITY – Panama	The Andean Community (Bolivia, Colombia, Ecuador, Peru and Venezuela) and Panama	Americas	Under neg.
23	Canada - Costa Rica	Canada, Costa Rica	Americas	Under neg.
24	Canada – MERCOSUR	Canada and MERCOSUR (Argentina, Brazil, Paraguay and Uruguay)	Americas	Under neg.
25	CARICOM – CACM	The CARICOM Community (Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago) and the CACM	Americas	Under neg.
26	Chile – CACM	Chile, Costa Rica, El Salvador, Honduras, Guatemala, Nicaragua	Americas	Under neg.
27	Free Trade of the Americas (FTAA/ALCA)	34 American countries.	Americas	Under neg.
28	MERCOSUR – ANDEAN COMMUNITY	MERCOSUR (Argentina, Brazil, Uruguay and Paraguay) and the Andean Community (Venezuela, Colombia, Ecuador, Peru and Bolivia)	Americas	Under neg.
29	MERCOSUR – CACM	MERCOSUR (Argentina, Brazil, Uruguay and Paraguay) and the Central American Common Market (Costa Rica, Guatemala, Honduras, El Salvador and Nicaragua)	Americas	Under neg.
30	MERCOSUR – CARICOM	Mercosur (Argentina, Brazil, Paraguay, Uruguay) and Caricom [Bahamas (1983), Barbados, Guyana, Jamaica, Trinidad and Tobago, Antigua and Barbuda, Belize, Dominica, Grenada, Haiti (1997), Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname (1995)]	Americas	Under neg.
31	MERCOSUR – Panama	MERCOSUR (Argentina, Brazil, Paraguay, Uruguay) and Panama	Americas	Under neg.
32	Mexico – Brazil	Mexico, Brazil	Americas	Under

				neg.
33	Mexico – Ecuador	Mexico, Ecuador	Americas	Under neg.
34	Mexico – Northern Triangle	Mexico, Guatemala, El Salvador, Honduras	Americas	Under neg.
35	Mexico – Panama	Mexico, Panama	Americas	Under neg.
36	Mexico – Peru	Mexico, Peru	Americas	Under neg.
37	Mexico – Uruguay	Mexico, Uruguay	Americas	Under neg.
38	Nicaragua – Honduras	Nicaragua, Honduras	Americas	Under neg.
39	United States – Chile	United States, Chile	Americas	Under neg.
40	India - Bhutan Trade and Commerce Agreement	India and Bhutan	Asia Pacific	In force
41	ASEAN Preferential Trading Arrangements (AFTA)	Brunei Darussalam (1987), Cambodia (1999), Indonesia, Laos (1997), Malaysia, Myanmar (1997), The Philippines, Singapore, Thailand, Vietnam (1995)	Asia Pacific	In force
42	Australia – New Zealand (ANZCERTA)	Australia, New Zealand	Asia Pacific	In Force
43	SAARC Preferential Trading Arrangement (SAPTA)	Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka	Asia Pacific	In force
44	Sri Lanka – India	India, Sri Lanka	Asia Pacific	In force
45	Australia – Papua New Guinea Agreement (PATCRA)	Australia, Papua New Guinea	Asia Pacific	In force
46	ASEAN – CER	Brunei Darussalam (1987), Cambodia (1999), Indonesia, Laos (1997), Malaysia, Myanmar (1997), The Philippines, Singapore, Thailand, Vietnam (1995), and Australia, New Zealand	Asia Pacific	Under neg.
47	Japan – Korea	Korea, Japan	Asia Pacific	Under neg.
48	Japan – Singapore	Japan, Singapore	Asia Pacific	Under neg.
49	Singapore – New Zealand	Singapore, New Zealand	Asia Pacific	Under neg.

50	South Pacific Forum	Australia, Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Nauru, New Zealand, Niue, Palau Papua New Guinea, Republic of the Marshall Islands, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu	Asia Pacific	Under neg.
51	Arab Free Trade Area (AFTA)	(18) Gulf Cooperation Council members (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates), Jordan, Tunisia, Egypt, Sudan, Syria, Somalia, Iraq, Palestine, Lebanon, Libya, Morocco, Yemen.	Cross-reg	In force
52	African Economic Community (AEC)	(53) Algeria, Angola, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Côte d'Ivoire, Democratic Republic of Congo, Djibouti, Egypt, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Gambia,	Cross-reg	In force
53	Burkina Faso – Tunisia	Burkina Faso – Tunisia	Cross-reg	In force
54	Canada - Israel	Canada, Israel	Cross-reg	In force
55	COMESA	Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Tanzania (out?), Uganda, Zambia and Zimbabwe.	Cross-reg	In Force
56	EC – Mexico	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom- and Mexico	Cross-reg	In Force
57	EC - South Africa	EC Members (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and South Africa	Cross-reg	In force
58	Estonia – Ukraine	Estonia, Ukraine	Cross-reg	In Force
59	Guinea – Morocco	Guinea, Morocco	Cross-reg	In force
60	Israel - United States	Israel, the United States	Cross-reg	In force
61	Latvia – Ukraine	Latvia, Ukraine	Cross-reg	In force
62	Mexico – Israel	Mexico and Israel	Cross-reg	In force
63	Palestinian Authority - United States	The Palestinian National Authority (PNA) and the United States (US)	Cross-reg	In force
64	Romania –	Romania, Moldova	Cross-reg	In Force

	Moldova			
65	Ukraine – Lithuania	Ukraine and Lithuania	Cross-reg	In force
66	Black Sea Economic Cooperation (BSEC)	(11) Albania, Armenia, Azerbaijan, Bulgaria, Georgia, (Greece), Moldova, Romania, Russia, Turkey and Ukraine.	Cross-reg	Under neg.
67	CACM – Taiwan	Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, Taiwan	Cross-reg	Under neg.
68	Canada - Palestinian Authority	Canada, Palestinian Authority	Cross-reg	Under neg.
69	EC – Chile	EC (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and Chile	Cross-reg	Under neg.
70	EC – MERCOSUR	EC (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and MERCOSUR members (Argentina, Brazil, Paraguay and Uruguay)	Cross-reg	Under neg.
71	EFTA – Canada	EFTA (Norway, Switzerland, Liechtenstein and Iceland) and Canada	Cross-reg	Under neg.
72	EFTA – Mexico	EFTA (Norway, Iceland, Switzerland, Liechtenstein) – Mexico	Cross-reg	Under neg.
73	Japan – Mexico	Japan, Mexico	Cross-reg	Under neg.
74	Jordan - United States	United States, Jordan	Cross-reg	Under neg.
75	Kazakhstan – Lithuania	Kazakhstan and Lithuania	Cross-reg	Under neg.
76	SACU – MERCOSUR	South Africa, Botswana, Lesotho, Namibia, Swaziland, Brazil, Uruguay, Argentina, Paraguay	Cross-reg	Under neg.
77	Singapore – Chile	Singapore, Chile	Cross-reg	Under neg.
78	Singapore – Mexico	Singapore, Mexico	Cross-reg	Under neg.
79	South Korea – Chile	South Korea and Chile	Cross-reg	Under neg.
80	Armenia - Russian Federation	Armenia and the Russian Federation	E.Eur.C.Asia	In force

81	Azerbaijan, Armenia, Belarus, Georgia, Moldova, Kazakhstan, the Russian Federation, Ukraine, Uzbekistan, Tajikistan and the Kyrgyz Republic	Azerbaijan, Armenia, Belarus, Georgia, Moldova, Kazakhstan, the Russian Federation, Ukraine, Uzbekistan, Tajikistan and the Kyrgyz Republic	E.Eur.C.Asia	In Force
82	Belarus – Ukraine	Belarus and Ukraine	E.Eur.C.Asia	In force
83	Belarus – Uzbekistan	Belarus and Uzbekistan	E.Eur.C.Asia	In force
84	Georgia – Azerbaijan	Georgia, Azerbaijan	E.Eur.C.Asia	In force
85	Georgia - Russian Federation	Georgia, Russian Federation	E.Eur.C.Asia	In force
86	Kyrgyz – Moldova	Kyrgyz Republic, Moldova	E.Eur.C.Asia	In Force
87	Kyrgyz - Russian Federation	Kyrgyz Republic, Russian Federation	E.Eur.C.Asia	In Force
88	Kyrgyz – Ukraine	Kyrgyz Republic, Ukraine	E.Eur.C.Asia	In Force
89	Kyrgyz – Uzbekistan	Kyrgyz Republic, Uzbekistan	E.Eur.C.Asia	In Force
90	Kyrgyz Republic – Kazakhstan	Kyrgyz Republic, Kazakhstan	E.Eur.C.Asia	In Force
91	Kyrgyz Republic / Russian Federation / Belarus / Kazakhstan Customs Union	Belarus, Kazakhstan, Kyrgyz Republic, Russian Federation	E.Eur.C.Asia	In Force
92	Moldova – Armenia	Moldova and Armenia	E.Eur.C.Asia	In force
93	Moldova – Azerbaijan	Moldova and Azerbaijan	E.Eur.C.Asia	In force
94	Moldova – Belarus	Moldova and Belarus	E.Eur.C.Asia	In force
95	Moldova – Kazakhstan	Moldova and Kazakhstan	E.Eur.C.Asia	In force
96	Moldova - Russian Federation	Moldova and the Russian Federation	E.Eur.C.Asia	In force
97	Moldova – Turkmenistan	Moldova and Turkmenistan	E.Eur.C.Asia	In force
98	Moldova – Ukraine	Moldova and Ukraine	E.Eur.C.Asia	In force
99	Moldova – Uzbekistan	Moldova and Uzbekistan	E.Eur.C.Asia	In force
100	Russia – Tajikistan	The Russian Federation and Tajikistan	E.Eur.C.Asia	In force
101	Russia – Ukraine	The Russian Federation and Ukraine.	E.Eur.C.Asia	In force
102	Russian Federation – Azerbaijan	Russia, Azerbaijan	E.Eur.C.Asia	In force
103	Russian Federation – Belarus	Russia, Belarus	E.Eur.C.Asia	In force

104	Russian Federation – Turkmenistan	Russia, Turkmenistan	E.Eur.C.Asia	In force
105	Russian Federation – Uzbekistan	Russian, Uzbekistan	E.Eur.C.Asia	In force
106	Ukraine – Azerbaijan	Ukraine, Azerbaijan	E.Eur.C.Asia	In force
107	Ukraine – Georgia	Ukraine, Georgia	E.Eur.C.Asia	In force
108	Ukraine – Turkmenistan	Ukraine, Turkmenistan	E.Eur.C.Asia	In force
109	Ukraine – Uzbekistan	Ukraine, Uzbekistan	E.Eur.C.Asia	In force
110	Armenia - Kyrgyz Republic	Armenia and Kyrgyz Republic	E.Eur.C.Asia	Under neg.
111	Armenia – Tajikistan	Armenia and Tajikistan	E.Eur.C.Asia	Under neg.
112	Armenia – Ukraine	Armenia and Ukraine	E.Eur.C.Asia	Under neg.
113	Central Asian Economic Community	Kazakhstan, Kyrgyz Republic, Uzbekistan & Tajikistan	E.Eur.C.Asia	Under neg.
114	Georgia - Armenia	Georgia, Armenia	E.Eur.C.Asia	Under neg.
115	Georgia - Turkmenistan	Georgia, Turkmenistan	E.Eur.C.Asia	Under neg.
116	Georgia - Uzbekistan	Georgia, Uzbekistan	E.Eur.C.Asia	Under neg.
117	Kazakhstan - Tajikistan	Kazakhstan and Tajikistan.	E.Eur.C.Asia	Under neg.
118	Kazakhstan - the Russian Federation	Kazakhstan and the Russian Federation	E.Eur.C.Asia	Under neg.
119	Kazakhstan - Ukraine	Kazakhstan and Ukraine	E.Eur.C.Asia	Under neg.
120	Moldova - Georgia	Moldova and Georgia	E.Eur.C.Asia	Under neg.
121	Arab Maghreb Union (AMU)	Algeria, Libya, Mauritania, Morocco and Tunisia.	Euro-Med	In force
122	Bulgaria - F.Y.R.O.M	Bulgaria, Former Yugoslav Republic of Macedonia	Euro-Med	In Force
123	Bulgaria - Turkey	Bulgaria and Turkey	Euro-Med	In Force
124	CEFTA	Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovak Republic, Slovenia	Euro-Med	In force
125	Croatia - F.Y.R.O.M.	Croatia, Former Yugoslav Republic of Macedonia	Euro-Med	In force
126	Czech Republic - Estonia	Czech Republic, Estonia	Euro-Med	In Force
127	Czech Republic - Israel	Czech Republic, Israel	Euro-Med	In Force

128	Czech Republic - Latvia	Czech Republic, Latvia	Euro-Med	In Force
129	Czech Republic - Lithuania	Czech Republic, Lithuania	Euro-Med	In Force
130	Czech Republic - Slovak Republic Customs Union	Czech Republic, Slovak Republic	Euro-Med	In Force
131	Czech Republic - Turkey	Czech Republic, Turkey	Euro-Med	In Force
132	EC - Andorra Customs Union	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Andorra	Euro-Med	In Force
133	EC - Bulgaria Europe Agreement	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Bulgaria	Euro-Med	In Force
134	EC - Czech Republic Europe Agreement	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and the Czech Republic	Euro-Med	In force
135	EC - Estonia Agreement	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Estonia	Euro-Med	In force
136	EC - Faroe Islands Agreement of 1997	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Faroe Islands	Euro-Med	In force
137	EC - Hungary Europe Agreement	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Hungary	Euro-Med	In Force
138	EC - Israel	EC Members (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and Israel.	Euro-Med	In force

139	EC - Jordan	EC Member States (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and Jordan	Euro-Med	In force
140	EC - Latvia Agreement	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Latvia	Euro-Med	In force
141	EC - Lithuania	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Lithuania	Euro-Med	In force
142	EC - Morocco	EC (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and Morocco	Euro-Med	In force
143	EC - Palestinian Authority	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and The Palestinian Authority of the West Bank and the Gaza Strip.	Euro-Med	In Force
144	EC - Poland Europe Agreement	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Poland	Euro-Med	In Force
145	EC - Republic of San Marino	EC (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and the Republic of San Marino.	Euro-Med	In force
146	EC - Romania Europe Agreement	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Romania	Euro-Med	In Force
147	EC - Slovak Republic Europe Agreement	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and the Slovak Republic	Euro-Med	In force

148	EC - Slovenia Interim Agreement	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Slovenia	Euro-Med	In Force
149	EC - Tunisia Euro-Mediterranean	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Tunisia	Euro-Med	In Force
150	EC - Turkey Customs Union	EC members (15) – Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Turkey	Euro-Med	In force
151	EEC - Cyprus Association Agreement	EC member states (15) - Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Cyprus	Euro-Med	In force
152	EEC - Iceland Agreement	EC Member states (15) - Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Iceland	Euro-Med	In Force
153	EEC - Malta Association Agreement	EC member states (15) - Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Malta	Euro-Med	In Force
154	EEC - Norway Agreement	EC Member States (15) - Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Norway	Euro-Med	In Force
155	EEC - Switzerland / Liechtenstein Agreement	EC member states (15) - Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom and Switzerland / Liechtenstein	Euro-Med	In force
156	EFTA	Iceland, Liechtenstein, Norway, Switzerland	Euro-Med	In Force
157	EFTA - Czech Republic Agreement	EFTA States (Iceland, Liechtenstein, Norway, Switzerland) and the Czech Republic	Euro-Med	In force

158	EFTA - Hungary Agreement	EFTA States – Iceland, Liechtenstein, Norway, Switzerland and Hungary	Euro-Med	In force
159	EFTA - Israel	EFTA members – Iceland, Liechtenstein, Norway, Switzerland and Israel	Euro-Med	In force
160	EFTA - Latvia	EFTA member states (Iceland, Liechtenstein, Norway and Switzerland) and Latvia	Euro-Med	In force
161	EFTA - Lithuania	EFTA member states (Iceland, Liechtenstein, Norway and Switzerland) and Lithuania	Euro-Med	In Force
162	EFTA - Morocco	The EFTA States (Iceland, Liechtenstein, Norway and Switzerland) and Morocco	Euro-Med	In Force
163	EFTA - PLO	EFTA States (Iceland, Liechtenstein, Norway, Switzerland) and the Palestinian Liberation Organization for the benefit of the Palestinian Authority	Euro-Med	In Force
164	EFTA - Poland Agreement	EFTA States – Iceland, Liechtenstein, Norway, Switzerland and Poland	Euro-Med	In force
165	EFTA - Romania Free Trade Agreement	EFTA States – Iceland, Liechtenstein, Norway, Switzerland and Romania	Euro-Med	In force
166	EFTA - Slovak Republic Agreement	EFTA States (Iceland, Liechtenstein, Norway, Switzerland) and the Slovak Republic	Euro-Med	In force
167	EFTA - Slovenia	EFTA member states (Iceland, Liechtenstein, Norway and Switzerland) and Slovenia	Euro-Med	In force
168	EFTA - Turkey Agreement	EFTA members – Iceland, Liechtenstein, Norway, Switzerland and Turkey	Euro-Med	In force
169	EFTA- Bulgaria	EFTA States – Iceland, Liechtenstein, Norway, Switzerland and Bulgaria	Euro-Med	In force
170	Estonia - Faroe Islands	Estonia, Faroe Islands / Government of Denmark	Euro-Med	In Force
171	Estonia - Latvia - Lithuania	Estonia, Latvia, Lithuania	Euro-Med	In Force
172	Faroe Islands - Iceland Free Trade Agreement	Denmark / Faroe Islands, Iceland	Euro-Med	In Force
173	Faroe Islands - Norway Free Trade Agreement	Denmark / Faroe Islands, Norway	Euro-Med	In force
174	Faroe Islands - Switzerland Free Trade Agreement	Denmark / Faroe Islands, Switzerland	Euro-Med	In force
175	Gulf Cooperation Council (GCC)	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia , United Arab Emirates (UAE)	Euro-Med	In Force

176	Hungary - Estonia	Hungary, Estonia	Euro-Med	In force
177	Hungary - Israel	Hungary, Israel	Euro-Med	In Force
178	Hungary - Latvia	Hungary, Latvia	Euro-Med	In Force
179	Hungary - Lithuania	Hungary, Lithuania	Euro-Med	In Force
180	Hungary - Turkey	Turkey, Hungary	Euro-Med	In Force
181	Israel - Palestinian Authority	Israel and the Palestinian Authority (PA)	Euro-Med	In force
182	Jordan - Morocco	Jordan and Morocco	Euro-Med	In force
183	Lebanon - Syria	Lebanon and Syria	Euro-Med	In force
184	Lebanon - UAE	Lebanon, UAE	Euro-Med	In force
185	Morocco - Tunisia	Morocco, Tunisia	Euro-Med	In force
186	Poland - Faroe Islands	Poland, Faroe Islands (Government of Denmark)	Euro-Med	In Force
187	Poland - Israel	Israel, Poland	Euro-Med	In Force
188	Poland - Latvia	Poland, Latvia	Euro-Med	In Force
189	Poland - Lithuania	Lithuania, Poland	Euro-Med	In Force
190	Romania - Turkey	Turkey, Romania	Euro-Med	In Force
191	Slovak Republic - Estonia	Slovak Republic, Estonia.	Euro-Med	In Force
192	Slovak Republic - Israel	Israel, Slovak Republic	Euro-Med	In Force
193	Slovak Republic - Latvia	Latvia, Slovak Republic	Euro-Med	In Force
194	Slovak Republic - Lithuania	Lithuania, Slovak Republic	Euro-Med	In Force
195	Slovak Republic - Turkey	Slovak Republic, Turkey	Euro-Med	In Force
196	Slovenia - Croatia	Croatia, Slovenia	Euro-Med	In Force
197	Slovenia - Estonia	Estonia, Slovenia	Euro-Med	In force
198	Slovenia - F.Y.R.O.M.	Slovenia, the Former Yugoslav Republic Of Macedonia	Euro-Med	In force
199	Slovenia - Israel	Israel, Slovenia	Euro-Med	In Force
200	Slovenia - Latvia	Latvia, Slovenia	Euro-Med	In force
201	Slovenia - Lithuania	Lithuania, Slovenia	Euro-Med	In Force
202	The Treaty of Rome	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom	Euro-Med	In Force
203	Turkey - Estonia	Estonia, Turkey	Euro-Med	In Force
204	Turkey - Israel	Israel, Turkey	Euro-Med	In Force
205	Turkey - Latvia	Turkey, Latvia	Euro-Med	In force
206	Turkey - Lithuania	Turkey, Lithuania	Euro-Med	In Force
207	Turkey - Poland	Turkey, Poland	Euro-Med	In Force
208	Turkey - Slovenia	Turkey and Slovenia	Euro-Med	In force
209	EFTA - Estonia Free Trade Agreement	EFTA member states (Iceland, Liechtenstein, Norway and Switzerland) and Estonia	Euro-Med	In Force

	Agreement	and Estonia		
210	EC - Algeria	EC Members (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and Algeria.	Euro-Med	Under neg.
211	EC - Egypt	EC Members (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and Egypt	Euro-Med	Under neg.
212	EC - Gulf Co-operation Council	EC Members (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, and United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and the Gulf Co-operation Council (Bahrain, Kuwait, Oman, Qatar, UAE, Saudi Arabia)	Euro-Med	Under neg.
213	EC - Lebanon	EC Members (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and Lebanon	Euro-Med	Under neg.
214	EC - Syria	EC Members (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Greece, Spain, Portugal, Finland, Sweden and Austria) and Syria	Euro-Med	Under neg.
215	EFTA - Albania	EFTA States (Switzerland, Iceland, Norway and Liechtenstein) and Albania	Euro-Med	Under neg.
216	EFTA - Cyprus	EFTA (Switzerland, Iceland, Norway and Liechtenstein) and Cyprus	Euro-Med	Under neg.
217	EFTA - Egypt	EFTA (Switzerland, Iceland, Norway and Liechtenstein) and Egypt	Euro-Med	Under neg.
218	EFTA - F.Y.R.O.M.	EFTA States (Switzerland, Iceland, Norway and Liechtenstein) and The Former Yugoslav Republic Of Macedonia	Euro-Med	Under neg.
219	EFTA - Gulf Cooperation Council	EFTA States (Norway, Iceland, Switzerland, Liechtenstein) and GCC (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates)	Euro-Med	Under neg.
220	EFTA - Jordan	EFTA (Switzerland, Iceland, Norway and Liechtenstein) and Jordan	Euro-Med	Under neg.

221	EFTA - Lebanon	EFTA (Switzerland, Iceland, Norway and Liechtenstein) and Lebanon	Euro-Med	Under neg.
222	EFTA - Malta	EFTA States (Switzerland, Iceland, Norway and Liechtenstein) and Malta	Euro-Med	Under neg.
223	EFTA - Tunisia	EFTA (Switzerland, Iceland, Norway and Liechtenstein) and Tunisia	Euro-Med	Under neg.
224	Egypt - Jordan	Egypt, Jordan	Euro-Med	Under neg.
225	Morocco - Egypt	Egypt, Morocco	Euro-Med	Under neg.
226	Morocco - Turkey	Morocco, Turkey	Euro-Med	Under neg.
227	Turkey - Egypt	Turkey, Egypt,	Euro-Med	Under neg.
228	Turkey - Palestinian Authority	Turkey, Palestinian Authority	Euro-Med	Under neg.

229	Turkey - Tunisia	Turkey, Tunisia	Euro-Med	Under neg.
230	West African Economic and Monetary Union (WAEMU)	Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal, Togo	Sub Saharan	In Force
231	Botswana - Zimbabwe	Botswana, Zimbabwe	Sub-Saharan	In force
232	Central African Economic and Monetary Union - CEMAC	Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon	Sub-Saharan	In force
233	Cross Border Initiative (CBI)	Burundi, Comoros, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe.	Sub-Saharan	In force
234	East African Cooperation (EAC)	Kenya, Tanzania, Uganda.	Sub-Saharan	In force
235	Economic Community of Central African States (ECCAS/CEEAC)	(11) Angola, Burundi, Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, Rwanda, Sao Tome and Principe and Democratic Republic of Congo.	Sub-Saharan	In force
236	Economic Community of Western African States (ECOWAS/CEDEAO)	(16) Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea- Bissau, Liberia, Mali, Mauritania (withdrew 1999?), Niger, Nigeria, Senegal, Sierra Leone and Togo.	Sub-Saharan	In force
237	Mano River Union (MRU)	Guinea (1980), Liberia and Sierra Leone.	Sub-Saharan	In force
238	South Africa – Malawi	The South African Republic and Malawi (1990, replacing a 1967 agreement),	Sub-Saharan	In force
239	Southern African Customs Union Agreement (SACU)	Botswana, Lesotho, Namibia (it became a de jure member on July 1990), Swaziland and South Africa.	Sub-Saharan	In force

240	Southern African Development Community (SADC)	(14) Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius (1995), Mozambique, Namibia (1990), The Seychelles, the South African Republic (1994), Swaziland, Tanzania, Zambia and Zimbabwe	Sub-Saharan	In force
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Under neg: Under negotiation
 Cross reg: Cross regional
 Americas: Central, South and North America and the Caribbean
 E. Euro. C. Asia: Eastern Europe / Central Asia
 Euro –Med: Europe / Mediterranean
 Sub-Saharan: Sub-Saharan Africa

Decision of the General Council dated 6 February 1996 Establishing the Committee on Regional Trade Agreements: see WT/L/127; 7 February 1996

Having regard to agreements¹ which are required to be notified, as the case may be, under Article XXIV of the General Agreement on Tariffs and Trade (GATT) 1994, Article V of the General Agreement on Trade in Services or the 1979 Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries;

Having regard to the biennial reporting envisaged in Paragraph 11 of the Uruguay Round Understanding on the Interpretation of Article XXIV of the GATT 1994; and

Acting pursuant to paragraphs 1 and 7 of Article IV of the Agreement Establishing the World Trade Organization (WTO),

The General Council hereby *decides*:

1. To establish a Committee on Regional Trade Agreements, open to all Members of the WTO, with the following terms of reference:
 - (a) to carry out the examination of agreements in accordance with the procedures and terms of reference adopted by the Council for Trade in Goods, the Council for Trade in Services or the Committee on Trade and Development, as the case may be, and thereafter present its report to the relevant body for appropriate action;²
 - (b) to consider how the required reporting on the operation of such agreements should be carried out and make appropriate recommendations to the relevant body;
 - (c) to develop, as appropriate, procedures to facilitate and improve the examination process;
 - (d) to consider the systemic implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them, and make appropriate recommendations to the General Council; and

¹The term "agreements" in this Decision refers to all bilateral, regional, and plurilateral trade agreements of a preferential nature.

²The Committee will also carry out the outstanding work of the working parties already established by the Council for Trade in Goods, the Council for Trade in Services or the Committee on Trade and Development, within the terms of reference defined for those working parties, and report to the appropriate bodies.

- (e) to carry out any additional functions assigned to it by the General Council.
2. That the Committee shall report annually to the General Council on its activities.

**STANDARD FORMAT FOR INFORMATION ON REGIONAL TRADE
AGREEMENTS: SEE WT/REG/W/6; 5 AUGUST 1996¹**

Note by the Chairman

The objective of the Standard Format for Information on Regional Trade Agreements is to facilitate and standardize the provision of initial information by parties to regional trade agreements.² Parties may adhere to the requirements of the Standard Format on a voluntary basis; in this respect, it should be viewed as Guidelines by the Chairman as to basic information that could be provided by parties notifying regional trade agreements to the WTO.

In line with the terms of reference adopted for the examination of regional agreements (including the accompanying understandings)³, the Standard Format includes some relevant information for the transparency and the consistency aspects of the examination process. The information requested in this Standard Format does not prejudice the scope and coverage of the consistency aspect of the examination process, nor does it replace the requirement for parties to regional trade agreements to provide Members with all relevant texts of laws and detailed trade and tariff data. Further, it does not preclude Members from posing questions in writing and seeking additional information from parties.⁴

As the information sought in the Standard Format relates primarily to trade disciplines applied in accordance with the regional trade agreement, it is unlikely that there would be a duplication of the information submitted to other WTO Bodies.

¹The Committee on Regional Trade Agreements, at its meeting of 31 July 1996, took note of the Standard Format for Information on Regional Trade Agreements.

²Information relating to trade in services may be integrated into the request for information in the light of the experience gained in the examination of agreements on trade in services.

³Starting with the terms of reference for the Enlargement of the European Communities adopted in the meeting of the Council for Trade in Goods held on 20 February 1995 (WT/REG3/1), all terms of reference are adopted together with an understanding by the Chairman which states that "although the Working Party would conduct its examination in light of the relevant provisions of the Agreements contained in Annex 1A of the WTO Agreement, the conclusions of the Report of the Working Party would be confined to reporting on consistency with the provisions of Article XXIV."

⁴"Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the CONTRACTING PARTIES and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate." (paragraph 7(a) of Article XXIV).

**STANDARD FORMAT FOR INFORMATION ON
REGIONAL TRADE AGREEMENTS**

Chairman's Guidelines

I. Background Information on the Agreement

1. Membership and dates of signature, ratification and entry into force.
2. Type of agreement
Customs union, free-trade area, preferential agreement among developing countries, interim agreement. Plan and schedule.
3. Scope
Products covered by, and excluded from, the Agreement, including data on trade coverage. Products to be covered by the Agreement at a later stage.
4. Trade data
Data on intra and extra-trade for the most recent period for which statistics are available, according to major products and partners. To the extent possible, available estimates on trade-creating and trade-diverting effects.

II. Trade Provisions

1. Import restrictions
Intra-trade restrictions currently in place and the trade affected by the restrictions. Time-table foreseen in the Agreement for dismantling the restrictions. Intra-trade restrictions that will remain in effect after the Agreement is fully implemented.
 - 1.1 Duties and charges
Customs duties, tariff quotas, charges having an equivalent effect to customs duties and fiscal duties on the trade of products covered by the Agreement: restrictions in place and trade affected, calendar for their dismantling, and residual restrictions.
 - 1.2 Quantitative restrictions
Quantitative restrictions (QRs) and measures having an equivalent effect to QRs on the trade of products covered by the Agreement: restrictions in place and trade affected, calendar for their dismantling, and residual restrictions.
 - 1.3 Common External Tariff
Methodology for establishing the Common External Tariff (CET). Stage of implementation of the CET. Information on negotiations under Article XXIV:6.

2. Export restrictions

Intra-trade restrictions currently in place and the trade affected by the restrictions. Time-table foreseen in the Agreement for dismantling the restrictions. Intra-trade restrictions that will remain in effect after the Agreement is fully implemented.

2.1 Duties and charges

Customs duties, tariff quotas, charges having an equivalent effect to customs duties and fiscal duties on the trade of products covered by the Agreement: restrictions in place and trade affected, calendar for their dismantling, and residual restrictions.

2.2 Quantitative restrictions

Quantitative restrictions and measures having equivalent effect to QRs on the trade of products covered by the Agreement: restrictions in place and trade affected, calendar for their dismantling, and residual restrictions.

3. Rules of origin

General criteria used for the purpose of determining the origin of products to which the Agreement applies; in particular, the criterion of substantial transformation (i.e. change in tariff classification, ad-valorem percentages and/or manufacturing or processing operations). Information on whether the rules of origin provide for any type of cumulation. Specific criteria to which certain sectors/products may be subjected.

4. Standards

Main elements of any provisions relating to standards to be applied on intra-trade; in particular, whether they provide for common standards or mutual recognition of certificates. In the case of customs unions, or interim agreements leading to a customs union, information on whether the parties intend to apply common standards for imports from third parties.

4.1 Technical barriers to trade

4.2 Sanitary and phytosanitary measures

5. Safeguards

Description of the emergency measures and other safeguard mechanisms applicable to intra-trade (e.g. balance-of-payments difficulties, developmental matters, special safeguards for agriculture), in cases where they differ from those applied on a MFN basis. In the case of customs unions, or interim agreements leading to a customs union, information on whether the parties intend to apply a common safeguard regime to imports from third parties. Information on whether the Agreement provides for the exclusion of parties to the Agreement from safeguard measures applied on imports from third parties.

6. Anti-dumping and countervailing measures

Description of the anti-dumping and countervailing measures applicable on intra-trade, in cases where they differ from those applied on a MFN basis. In the case of customs unions, or interim agreements leading to a customs union, information on whether the parties intend to apply a common regime on anti-dumping and countervailing measures to imports from third parties.

7. Subsidies and State-aid

Description of the treatment provided for in the Agreement relating to subsidies and State-aid, and an indication of the remedies available under the Agreement to counter their effects on intra-trade.

8. Sector-specific provisions

Specific provisions applicable to intra-trade in individual sectors (e.g. agriculture, fisheries, textiles and clothing, automotive sector). In the case of customs unions, or interim agreements leading to a customs union, information on whether the parties intend to apply any common sector-specific regime on imports from third parties.

9. Other

Information on provisions relating to, for example, cooperation in customs administration, import licensing and customs valuation, in cases where they differ from those applied on a MFN basis. Intra-trade treatment of products from free-trade zones established in any of the parties to the Agreement.

III. General Provisions of the Agreement

1. Exceptions and reservations

General and security exceptions provided for in the Agreement. Reservations entered into by any of the parties to the Agreement.

2. Accession

Information on any provision that allowing other countries to accede to the Agreement.

3. Dispute settlement procedures

Description of the mechanisms provided for resolving disputes among parties to the Agreement, and its relationship with intergovernmental dispute settlement instruments entered into by the parties under other bilateral, plurilateral and/or multilateral agreements.

4. Relation with other trade agreements

Information relating to whether or not the Agreement establishes any specific relation with other bilateral, plurilateral and/or multilateral trade agreements.

5. Institutional framework

Structure and functions of intergovernmental and/or supranational institutions created to operate the Agreement. Responsibilities of national entities for formulating and implementing policies relating to the Agreement.

IV. Other

For transparency purposes, any other relevant information related to the provisions of the Agreement.

**PROCEDURES ON REPORTING ON REGIONAL TRADE AGREEMENTS;
APPROVED BY THE COUNCIL FOR TRADE IN GOODS ON 30 NOVEMBER
1998: SEE G/L/286; 16 DECEMBER 1998**

The following procedures recommended by the Committee on Regional Trade Agreements have been approved by the Council for Trade in Goods as general guidelines with respect to biennial reports/information on regional trade agreements submitted to it:¹

1. Such reports/information will also be made available to the Committee on Regional Trade Agreements, since they are deemed to be particularly relevant to its specialized tasks. This will serve to enhance transparency on how regional trade agreements are proceeding and as an input to the Committee's work under item 1(d) of its terms of reference.
2. Where appropriate, the reports should include a description of developments in the agreements not contained in the information previously presented to the GATT/WTO² and trade statistics covering the last representative period, for both trade among parties to the agreements and trade with third parties.^{3,4}

¹ Regional trade agreements (RTAs) whose parties must report to the Council for Trade in Goods are customs unions, free-trade areas and interim agreements leading to the formation of a customs union or a free-trade area, notified under Article XXIV:7(a) of the GATT 1994. After the examination of the RTAs in accordance with paragraph 7 of the Understanding on the Interpretation of Article XXIV of the GATT 1994 (the Understanding), carried out by the Committee on Regional Trade Agreements, parties to the agreements are required to provide additional information/reports in the following cases:

- In the case of interim agreements undergoing "substantial changes" in the plan and schedule, parties should notify those changes (paragraph 9 of the Understanding).
- In the case of customs unions and free-trade areas, biennial reports are due on the "operation of the relevant agreement" (first sentence of paragraph 11 of the Understanding).
- In the case of customs unions and free-trade areas, "[a]ny significant changes and/or developments" are to be reported "as they occur" (last sentence of paragraph 11 of the Understanding).

Furthermore, in the case of interim agreements for which a further review is foreseen (under paragraph 8 of the Understanding), parties might also be required to supply supporting information.

² Particular attention should be given to the internal process of liberalization; to changes introduced with respect to the treatment of third parties; and to modifications to the rules of the agreements.

³ In case particular products were excluded from, or partially covered by, the regional liberalization process, the relevant data should also be provided.

⁴ Statistical information could be based on relevant annual data submitted to the Secretariat by the parties in accordance with the General Council Decision on 16 July 1997 (WT/L/225).

3. Where appropriate, parties to the agreements may make use, in the presentation of reports, of the Standard Format for Information on Regional Trade Agreements (document WT/REG/W/6). This would facilitate both the task of parties in reporting on their agreements and the task of WTO Members in considering the reports.

4. The Council for Trade in Goods and the Committee on Regional Trade Agreements will regularly receive an updated time-table for the submission of biennial reports on regional trade agreements, to be prepared by the Secretariat in coordination with the Members involved.

The above procedures will not in any way affect the legal rights and obligations of WTO Members.

GUIDELINES ON PROCEDURES TO IMPROVE AND FACILITATE THE
EXAMINATION PROCESS¹: SEE WT/REG/W/15; 6 MAY 1997

Note by the Chairman

The Committee on Regional Trade Agreements (RTAs) has been mandated "to develop, as appropriate, procedures to facilitate and improve the examination process" (item 1(c) of its Terms of Reference).

The Guidelines, which have been drawn up on the responsibility of the Chairman of the Committee, define some procedural steps which might facilitate and improve the examination process. These Guidelines are to be considered evolutionary and can be reviewed, in light of experience.

For ease of reference, procedural steps have been grouped, when feasible, according to the following four phases to which relations of a RTA with the WTO may be linked:²

- I. Notification by the Parties
- II. Initial information on the RTA
- III. Examination according to relevant terms of reference
 - (a) Exchange of views on the RTA's conformity to relevant WTO rules
 - (b) Supplementary written and oral information on the RTA
 - (c) Elaboration of the report on the examination
- IV. Decision on appropriate action by the relevant body

¹The Committee on Regional Trade Agreements, at its meeting on 2 May 1997, took note of the Guidelines on Procedures to Improve and Facilitate the Examination Process.

²"Reporting on the operation of RTAs" would constitute a fifth phase (please refer to document WT/REG/W/3). The Committee has also been mandated "to consider how the required reporting on the operation of [RTAs] should be carried out and make appropriate recommendations to the relevant body" (item 1(b) of the Terms of Reference).

PROCEDURES TO IMPROVE AND FACILITATE THE EXAMINATION PROCESS

Chairman's Guidelines

1. With the aim of enhancing transparency and assisting the Committee in its work, WTO Members engaged in the process of establishing a RTA are invited to share with the Committee relevant information in the early stages of such process, prior to making the formal notification.
2. Opportunity will be provided at meetings of the Committee, separately from the process of examination, for Members to seek information on RTAs that have not yet been notified.

I. Notification by the Parties

3. WTO Members' notification obligations for RTAs are contained in the following provisions:

GATT 1994 "Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the CONTRACTING PARTIES and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate." *Article XXIV:7(a)*

"Any contracting party taking action to introduce an arrangement pursuant to paragraph ... 3 above or subsequently taking action to introduce modification or withdrawal of the differential and more favourable treatment so provided shall notify the CONTRACTING PARTIES and furnish them with all the information they may deem appropriate relating to such action."³ *Enabling Clause, para. 4(a)*

GATS "Members which are parties to any agreement referred to in paragraph 1 shall promptly notify any such agreement and any enlargement or any significant modification of that agreement to the Council for Trade in Services. They shall also make available to the Council such relevant information as may be requested by it."⁴ *Article V:7(a)*

³Paragraph 3 reads as follows: "Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another".

⁴Paragraph 1 refers to agreements "liberalizing trade in services between or among the parties to such an agreement".

4. The Parties to a RTA should supply the relevant treaties or agreements to the Secretariat together with the text of the notification for circulation to Members as official WTO documents. After consideration by the relevant WTO body,⁵ the terms of reference for the examination of a notified RTA, if any, are adopted by that body and the examination is referred to the Committee.

5. A register of the information provided to WTO Members on each RTA will be maintained by the Secretariat and made available to the Committee periodically.

II. Initial information on the RTA

6. The Committee, before proceeding with a first round of examination of a notified RTA, may require some initial, basic information, to be conveyed by the Parties:

- (i) according to the Chairman's Guidelines on a "Standard Format for Information on RTAs" (document WT/REG/W/6) or those on a "Standard Format for Information on Economic Integration Agreements on Services" (document WT/REG/W/14);
- (ii) in the form of written replies to written questions submitted by interested Members.

7. Though optional, the use of the Standard Formats by the Parties is strongly encouraged, as a means of supplying initial information on RTAs in a structured and comprehensive way.

8. Once the examination of a RTA has been referred to the Committee, the Chairperson, in consultation with the Parties, should establish a work programme for the examination of the individual RTA, in particular with respect to the format and timing of the submission of initial information, and the scheduling of the first examination meeting. The Committee should be informed, as soon as possible, of that work programme.

9. Information made available under the corresponding Standard Format, or resulting from the preliminary questions-and-replies process, should be circulated to Members as a formal document at least three weeks before the first round of examination of the RTA.⁶

III. Examination according to relevant terms of reference

10. In the case of RTAs notified under both GATT 1994 and GATS provisions, examination of the "goods" and "services" aspects should be dealt with back-to-back, wherever possible.

11. With respect to the period devoted by the Committee to the examination of a RTA, or the number of meetings for treating a single RTA, flexibility should be allowed.

⁵The Council for Trade in Goods, the Council for Trade in Services or the Committee on Trade and Development, as the case may be.

⁶To speed up the processing and dissemination of information (including trade data), delegations should submit it electronically, whenever possible.

More expedient examinations could take place on an *ad hoc* basis, once all interested Members agreed that there was no need to pursue issues further or pose further questions to the Parties to an RTA.

(a) Oral supply of information on the RTA and exchange of views on its conformity to relevant WTO rules

12. The Secretariat shall elaborate summary minutes for Committee deliberations related to the examination of individual RTAs.⁷ These should be made available to Members at least three weeks before another round of examination is scheduled for the corresponding RTA.⁸

(b) Supplementary written information on the RTA

13. Supplementary information on individual RTAs may be required throughout the examination process. Members should endeavour to submit written questions sufficiently in advance to enable the corresponding replies by the Parties to be made available to the Committee at least three weeks before the meeting scheduled for examining the RTA.

(c) Elaboration of the report on the examination

14. The report would consist of a "factual record" of the examination and the "conclusions" reached by the Committee. The summary minutes of CRTA meetings devoted to the examination of individual RTAs (paragraph 12 above) would constitute the factual account of the examination report, embodying all comments and views expressed by delegations in the course of the examination. The Committee's assessment of a RTA, according to the mandate, would constitute the "conclusions" part of the report, to be presented to the Committee in draft form for consideration and agreement.

15. The report on the examination of each individual RTA could follow the draft format outlined below:

A. Background

1. Notification of the RTA to the relevant body/bodies.
Brief description of the main features of the RTA.
2. Terms of reference of the examination.

B. Factual Record of the Examination

1. Dates of meetings devoted to the examination and Chairmanship
2. List of basic documentation, to be annexed
3. Summary minutes of deliberations, to be annexed⁹

⁷The use of the Standard Formats to present preliminary information would allow examination discussions at meetings to become more structured along the headings there identified and assist with the timely preparation of summary minutes.

⁸Factual corrections of summary minutes will be dealt with through Corrigenda to the original document and incorporated in the final, consolidated version annexed to the examination report.

⁹Summary minutes annexed to the report would take the form of one consolidated document, whenever practical.

C. Conclusions of the Examination of the RTA in Accordance with the Agreed Terms of Reference and in the Light of the Relevant Provisions of the WTO

16. Annexes to the examination report, in particular those listed under B.2 and B.3 above, would form an integral part of the report to be adopted by the Committee and then transmitted to the relevant body, according to the terms of reference of the examination.

IV. Decision on appropriate action by the relevant body

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