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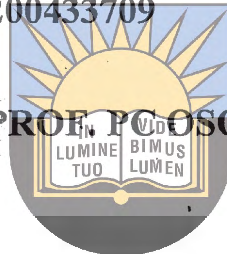

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RESEARCH TOPIC FOR LLM DISSERTATION:

The Interpretation Problems Surrounding GATT Article XXIV and their Implications for Multilateralism in the WTO System

Dissertation

Submitted in fulfilment of the requirement for the Degree of Master of Laws in the Faculty of Law at the University of Fort Hare, South Africa.

Declaration

Except for references specifically indicated in the text, and such help as I have acknowledged, this thesis is wholly my own work and has not been submitted for degree purposes at any other University.

Mpho Modiro-Marata

East London

06 December 2009

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Abstract

The proliferation of Regional Trade Agreements (RTAs) has attracted a lot of attention in contemporary discussions of multilateral trade regulation. There were widespread attempts at regional trade agreements in the early 1920s but it is the current spate of RTAs that continues to cause a lot of controversy among trade policy makers and analysts alike. There are compelling socio-economic and political factors that make RTAs attractive tools for further liberalization of trade. Likewise, it can not be denied that the same presents the world trading system with challenges, which if not managed could divide world trade as was experienced in the 1930s. While the World Trade Organization (WTO) has put in place rules and mechanisms to ensure that RTAs do not become protectionist entities, it has found it hard to enforce them.

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This study argues that the problematic issues encountered as a result of the interpretation of the provisions of Article XXIV of the General Agreement on Tariffs and Trade of 1994 (GATT) have created gaps which make it easier for WTO members to default or deviate from their wider obligations under the General Agreement on Tariffs and Trade. The GATT regulations seek to ensure that RTAs are complementary to the multilateral trading system. However they lack the proper institutional structure to manage the ever increasing number of RTAs and this in turn has left the GATT open for potential abuse by members. The study will discuss what RTAs are, how they operate and how they are a deviation from the GATT's main principle of non-discrimination including reasons why they are sanctioned by the GATT. In addition to employing WTO case law to illustrate the above, the pertinent provisions of the Southern African Development Community (SADC) legal framework will be analyzed to determine extent of compliance with the GATT and the implications thereof.

Acknowledgements

I would like to express my sincere thanks to my supervisor, Professor PC Osode, for his assistance, encouragement, intellectual stimulation and support despite his extremely heavy workload.

My gratitude also extends to:

i) My parents, for the emotional, financial support and assistance they have provided throughout my studies.

ii) Bandile Mabandla for his love, support and belief in me.

iii) All the staff of the Trade Law Centre of Southern Africa, Stellenbosch for allowing me to use their resources.

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The financial assistance of the Govan Mbeki Research and Development Centre, South Africa, towards this research is hereby acknowledged. Opinions expressed and conclusions arrived at are those of the author and are not to be attributed to the Centre.

Finally, I would like to thank God, without whom all this would not have been possible.

Acronyms

CRTA	Committee on Regional Trade Agreements
CU	Customs Union
FTA	Free Trade Area
GATT	The General Agreement on Tariffs and Trade
MFN	Most-Favoured Nation principle
ORC	Other Regulations of Commerce
ORRC	Other Restrictive Regulations of Commerce
RoOs	Rules of Origin
RTAs	Regional Trade Agreements
SADC	Southern African Development Community
SAT	Substantially All Trade
WTO	World Trade Organization

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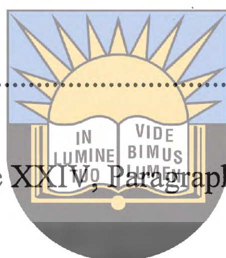

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CHAPTER 1

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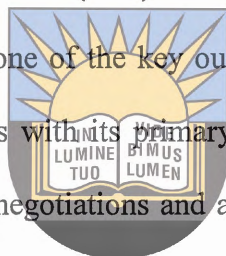
INTRODUCTION

1.1 Introductory background

The idea of globalization and world trade liberalization has been vigorously debated over the past few years. The establishment of the World Trade Organization[1] has been hailed by some commentators as the completion of the third pillar of the world economic system, taking its place beside the International Monetary Fund (IMF) and the World Bank.[2] The WTO, which came into being in January 1995, was one of the key outcomes of the 1986-1994 Uruguay Round of multilateral trade negotiations with its primary responsibility being to provide a permanent forum for multilateral trade negotiations and an institutional framework for their implementation.[3] Since the WTO's inception, the world has witnessed a rapid growth in international economic activity as well as an expansion of its activities in recent years.[4]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Prior to the establishment of the WTO, the General Agreement on Tariffs and Trade[5] was the only multilateral framework for international trade regulation. The GATT now represents one of several agreements administered by the WTO and is the most "ambitious and far-reaching" international trade agreement ever concluded.[6] While there is general agreement on the trade policy goals of multilateralism and non-discrimination, countries have nevertheless been frustrated with the GATT.[7] Today the situation as it is, fuelled by setbacks in the WTO, has seen disappointment with the eagerly awaited progress in trade liberalization. There have

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[1] Hereinafter the WTO.
[2] Jackson *The World Trade Organization: Constitution and Jurisprudence* (1998) xiii.
[3] Bowen, Hollander and Viaene *Applied International Trade Analysis* (1998) 59.
[4] Subedi "The Notion of Free Trade and the First Ten Years of the World Trade Organization: How Level is the 'Level Playing Field'?" 2006 *Netherlands International Law Review* 273 275.
[5] Hereinafter the GATT.
[6] Van den Bossche *The Law and Policy of the World Trade Organization: Text, Cases and Materials* (2005) 45.
[7] During the Uruguay Round there was considerable interest in the proliferation of regional trade agreements; in particular, in identifying the intentions of the parties to these agreements. See Jackson 55.

been questions raised as to whether the WTO as an institution has been overly constrained by the various checks and balances to enable it to respond effectively to the many changes in the economic and market forces.[8] Trade negotiations at the WTO are slow and often frustrated by divergent views between developed nations and developing states and sometimes even among developed nations or among developing nations.[9] For instance, during the Tokyo Round (1973-1979), many of the problems characterizing the period were subject to negotiation and these included protectionism in the agricultural and textile sectors, as well as non-tariff trade barriers and the abuses of the GATT rules of exceptions.[10] The Tokyo Round did bring about a reduction in the average tariff protection level for manufactured goods but did not get anywhere with regard to agriculture and textiles.[11]

The result of these hold ups has been among other things, a staggering increase of Regional Trade Agreements.[12] More and more countries are now becoming parties to new or existing RTAs. It is currently argued that the current deadlock in the Doha Round of Trade Negotiations[13] is due to the increasing complexity of economic globalization; that this state of affairs represents a transformative shift on the part of member states away from the current mode of trade multilateralism and towards smaller negotiating platforms.[14] With some adding

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[8] Jackson 58.

[9] Matsushita "Legal Aspects of Free Trade Agreements in the context of Article XXIV of the GATT 1994". Available at www.worldtradelaw.net.pdf (accessed 19/05/08).

[10] Gibb and Michalak (eds) *Continental Trading Blocks: The Growth of Regionalism in the World Economy* (1994) 145. The GATT provides for a number of exceptions allowing contracting parties to deviate from the non-discrimination principle. These include: General exceptions (Article XX), Security exceptions (Article XVI), Subsidies (Article XVI) and Safeguard measures for the balance of payments (Article XII). See Heiskanen "The Regulatory Philosophy of International Trade Law" 2004 Journal of World Trade 1 2.

[11] See Athukorala "Agricultural Trade Reforms in the Doha Round: A Developing Country Perspective" 2004 *Journal of World Trade* 877 895.

[12] Hereinafter RTAs.

[13] The multilateral trade system evolved and continues to evolve through a series of trade negotiations. The latest of these trade negotiations or rounds is the Doha Round, commonly referred to as the Doha Development Agenda (DDA). The November 2001 Declaration of the fourth Ministerial Conference in Doha, Qatar provides for a mandate for negotiations on a range of subjects and other work including issues concerning the implementation of current agreements of the WTO. There are 21 subjects listed in the Doha Declaration one of which concerns RTAs. See Taylor "Regionalism: The Second-Best Option? 2008 Saint Louis University Public Law Review 155 156-157.

[14] Drache and froese "Deadlock in the Doha Round: The Long Decline of Trade Multilateralism". Available at www.yorku.ac/drache (accessed 21/11/08).

that RTAs can help diffuse protectionist pressures especially in the current economic crisis.[15] It appears however that this is not a new development. There were widespread attempts at regional trade agreements in the 1960s, which largely failed.[16]

Integration processes create closer political and/or economic links between nations. These links are complex and difficult because they involve the building of bridges across some part of the divisions created by national boundaries.[17] Geographical proximity and a common cultural background make the integration process easier to accomplish, yet neither location nor culture is the cause of the search for larger areas within which to pursue the benefits of cooperation.[18] Governments have to agree to some form of common action which will reflect the extent to which they feel that some part of their interests will be better promoted acting together than apart.[19]

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The configuration of trade groupings is diverse and becoming increasingly complex with overlapping RTAs spanning within and across continents at regional and sub-regional levels. The simplest configuration is a bilateral agreement formed between two parties and these account for more than half of all RTAs in force and for almost sixty per cent of those under negotiation.[20] More complex are plurilateral RTAs and those agreements in which one of the parties is an RTA itself; the latter accounts for twenty-five per cent of the RTAs in force.[21]

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[15] Soesastro "What Should World Leaders do to Halt Protectionism from Spreading" in Baldwin and Evenett (eds) *Essays: What World Leaders Must do to Halt the Spread of Protectionism* (2008) 5.
[16] Frankel, Stein and Wei *Regional Trading Blocs in the World Economic System* (1997) 1.
[17] Manley "The Caribbean Community envisioned by its fore fathers and a reality 25 years later". Available at http://www.silvertorch.com/arts/manley1.htm (accessed 24/04/08).
[18] Mavroidis advances similar reasons why countries become parties to RTAs. Most notable is his suggestion that countries could also resort to RTAs because they lack the productivity rate that would allow them to compete on the international plane. See Mavroidis *The General Agreement on Trade and Tariffs: A Commentary* (2005) 226.
[19] Manley "The Caribbean Community envisioned by its fore fathers and a reality 25 years later". Available at http://www.silvertorch.com/arts/manley1.htm (accessed 24/04/08).
[20] The WTO Secretariat "Regional Trade Integration under Transformation" *Preliminary Draft Report prepared for the Seminar on Regionalism and the WTO* (2002) 4.
[21] For example, in October 2008 at a Tripartite Summit the Southern African Development Community (SADC), The East African Community (EAC) and the Common Market for East and Southern Africa (COMESA) announced their intention to create a free trade area comprising the regional economic

An additional category of RTAs are concluded among developed and developing nations. In terms of their scope and depth, RTAs differ considerably with some providing for the exchange of tariff preferences on a limited range of products and others being highly comprehensive in coverage and including wide ranging regulatory regimes.[22]

It will be seen that the formation of RTAs is driven by a variety of factors which include economic, political and security considerations. They may be driven by the search for access to larger markets which might be easier to engineer at regional or bilateral level, particularly in the absence of a willingness among WTO members to liberalize further on a multilateral basis.[23] They may further be used by some countries as a vehicle for promoting deeper integration of their economies than is presently available through the WTO, particularly for issues which are not fully dealt with multilaterally, such as investment, competition, environment and labour standards.[24]

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Strictly speaking, RTAs are a breach of the GATT idea of the multilateral removal of trade barriers and the pre-eminent principle of non-discrimination.[25] However, an exception to this was provided for in the GATT under Article XXIV where under certain conditions, countries may establish customs unions or free trade areas. GATT Article XXIV is based partly on the historical precedent of special regimes of frontier traffic between adjacent countries, but also on the principle that total world welfare can be enhanced by regimes of trade that totally eliminate restrictions to trade among several countries.[26] The United States supported the enactment of this exception in 1947 because of the opportunity it afforded to build up

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communities. Others include an Economic Partnership Agreement (EPA) between the Southern African Customs Union (SACU) and the European Union (EU) and with SADC. See Bosi, Breytenbach, Hartzenburg, McCarthy and Schade (eds) 2008 *Monitoring Regional Integration in Southern Africa Yearbook* 2.

[22] The WTO Secretariat "Regional Trade Integration under Transformation" *Preliminary Draft Report prepared for the Seminar on Regionalism* (2002) 4.

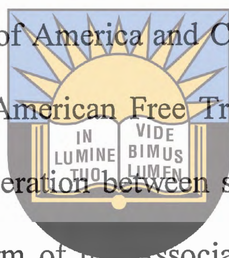
[23] Crawford and Fiorentino "The Changing Landscape of Trade Agreements" Discussion Paper No 8: World Trade Organization. Available at http://www.wto.org (accessed 18/04/08).

[24] *Ibid.*

[25] Gibb and Michalak *Continental Trading Blocs* (1994) 142.

[26] Jackson 54.

Western European regional cooperation, which America favoured. The European Community (EC) started in 1957 and since then it has been extended to include more countries. Although the common tariff barrier of the EC has been gradually lowered, the rest of the world has had problems with the discriminating elements of EC trade cooperation.[27] From the middle of the 1980s, there were rising fears that the EC would turn itself into "fortress Europe" which would then discriminate increasingly against the rest of the world by allowing a free internal market while putting up barriers against products from the rest of the world.[28] This fear contributed to the resurgence of interest in regional trade cooperation during the latter half of the 1980s.[29] In 1988, the United States of America and Canada established a free trade area which expanded to become the North American Free Trade Area (NAFTA) when Mexico joined in 1992. During the 1980s, cooperation between several South East Asian countries was extended and structured in the form of the Association of South East Asian Nations (ASEAN).[30] There were also plans for an Asia Pacific Economic Cooperation (APEC). Similarly in Africa and Latin America efforts were made to establish regional trading cooperation in the form of customs unions and free trade areas.[31] These RTAs between developing countries have not met with the same degree of success as those between developed countries.[32]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According to Bhagwati, the rationale for the inclusion of Article XXIV in the GATT appears to have been the following:

[27] Kjeldsen-Kragh *International Trade Policy* (2001) 143.
[28] *Ibid.*
[29] Capling "The Multilateral Trading System at Risk: Three Challenges to the World Trade Organization" in Buckley (ed) *The WTO and the Doha Round: The Changing Face of World Trade* (2003) 40.
[30] *Ibid.*
[31] *Ibid.*
[32] They were largely protectionist in that they maintained high external barriers and interventionist in the sense that they sought to determine administratively which industries to have and where they should be located. See Hoekman and Kostecki *The Political Economy of the World Trading System: The WTO and Beyond* (2001) 348.

- Firstly, that full integration of trade, that is, going all the way down to freedom of trade flows among any subset of GATT members would have to be allowed since it created an important element of single-nation characteristics (such as virtual freedom of trade and factor movements) among these nations and implied that the resulting quasi-national status flowing from such integration in trade legitimated the exception to the Most-Favoured Nation (MFN) obligation towards other members;[33]
- Secondly, that one could think of Article XXIV as permitting a supplemental, practical route to the universal free trade that the GATT favoured as the ultimate goal;[34]
- And thirdly, that the fact that the exception would have permitted only for the extremely difficult case where all trade barriers would need to come down, seemed to preclude the possibility that all kinds of preferential arrangements would break out, returning the world to the fragmented, discriminatory bilateralism-infested situation of the 1930s.[35]

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Bhagwati further notes the "tension between intention and reality" which goes against what the original drafters of Article XXIV intended and sketches briefly the important respects in which the original intention of Article XXIV was reasonably clear but was occasionally violated in spirit.[36] Whether the inclusion of this exception favours the ultimate goal of the WTO or not is what this dissertation will attempt to uncover.

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33 Bhagwati *The World Trading System at Risk* (1991) 65.
34 *Ibid.*
35 *Ibid.*
36 *Ibid.*

1.2 Research Problems

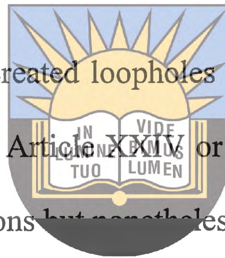
The research problems pursued in this study can be articulated as follows:

- There are significant difficulties in interpreting the WTO conditions on regionalism.

Many commentators have expressed regret over the inclusion of Article XXIV into the GATT, for example:

> "Article XXIV is "extremely elastic" (Curzon, 1965:64), "unusually complex" (Dam, 1970:275), and "full of holes" (Bhagwati, 1993:44) due to language that is full of "ambiguities" and "vague phrases" (Haight, 1972:397. Haight (1972:398) impugns Article XXIV as an "absurdity" and a "contradiction", while Dam (1970:270) brands it "a failure, if not a fiasco"[37]

These problems of interpretation have created loopholes that make it easier for countries to violate or depart from the provisions of Article XXIV or to align their agreements in a way that seems consistent with WTO provisions but nonetheless incompatible.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- There exists a possibility that the formation of a RTA may lead to a loss of GATT rights accorded multilaterally in favour of rights exchanged between the RTA partners.

- The study will explore why there are so many countries ready to accept rules and disciplines at a bilateral level that they are not prepared to accept at the multilateral level as well as why RTAs are permitted MFN deviation and investigate the forces that influenced the inclusion of Article XXIV in to the GATT and who would benefit from it.

- Furthermore, the study will explore ways in which regionalism affects the progress of multilateral trade liberalization through a mixture of changing internal incentives for

[37] Chase "Multilateralism Compromised: The Mysterious Origins of the GATT Article XXIV" 2006 *World Trade Review* 1.

trade liberalization, affecting the way in which RTA members interact and their relations with the rest of the world. A case analysis of the Southern African Development Community (SADC) will be included here to demonstrate this point.

1.3 Delimitation of the scope

Because this is an extensive subject, the main discussion will be based on Article XXIV of the GATT, as it is the primary provision that authorizes MFN deviation. Consequently, this has led to the formation of trade groupings taking advantage of the exception. However, political and economic aspects will also be included as forces that have had an impact on the subject.

The historical background for the inclusion of Art XXIV will be traced so as to show its foundational aspects and reasons for its inclusion. In this way, it will make it easier to understand why it was created and whom it was intended to benefit.

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This dissertation covers Article XXIV of the GATT, relating only to trade in goods. This means that similar provisions found in Article V of the General Agreement on Trade in Services (GATS) as well as the Enabling Clause and the Generalized System of Preferences (GSP) fall outside the scope of this research.

On the whole, the study will be structured in way that tries to assess whether regionalism does indeed pose a risk to multilateralism with particular reference to the inclusion of Art XXIV.

1.4 Importance of the Research

Given the fact that GATT rules and the current multilateral trade liberalization process are by no means perfect due to a number of significant shortcomings it seems likely that regional arrangements will continue to become an increasingly important feature of the international

trade system and their significance should not be underestimated. The significance of this research will be to scrutinize the reasons behind the inclusion of Article XXIV in a bid to expose or unearth the fears created by RTA proliferation, and upon evaluation to show whether these fears are misguided or not.

1.5 Objectives

The number of RTAs has been progressively increasing over the years.[38] This proliferation of RTAs presents WTO members and the multilateral trading system with challenges and opportunities. It is therefore crucial to understand the rights afforded to regional groupings and their limitations thereof and the impact they have on rights accorded multilaterally, put differently; does the recognition of the one infringe the operation or lead to a loss of the other.

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There is still controversy surrounding definitional terms and interpretation of Article XXIV of the GATT. This means that there is still confusion among WTO members on how to comply with the provisions of this Article. This study will therefore also look at the problems of interpretation surrounding Article XXIV and whether these problems of interpretation have created avenues or loopholes that render WTO rules on RTAs susceptible to abuse by members.

Since the nature of RTAs is just that they are regional, they can not solve global problems, such as, environmental issues. Multilateralism on the other hand, provides a forum where countries can negotiate reductions in their trade barriers on a global scale.[39] In a sense, the WTO is more far reaching. It is for this reason that a study into the internal and external policies of SADC will be undertaken to show the extent to which formation of regional

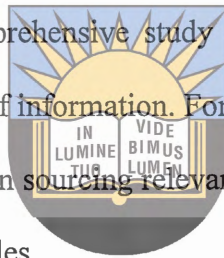
[38] Whalley "Regional Trading Agreements: Why so many, so fast, so different and where are they headed?" Available at http://ssrn.com/abstract=941445 (accessed 22/05/08).
[39] Picker "Regional Trade Agreements versus the WTO: A Proposal for Reform of Article XXIV to counter this Institutional Threat". Available at www.ssrn.com (accessed 22/05/08).

groupings is inherently protective (or not). The discussion in this chapter will effectively serve as a case study showing that the interpretation and implementation challenges of Article XXIV are real and not merely theoretical.

Should it be found that the provisions of Article XXIV and the experience of WTO member states compliance do indeed pose a threat to multilateralism, recommendations for reform will be proposed.

1.6 Research Methodology

Research of this kind involves a comprehensive study of existing literature. Library and electronic media will be major sources of information. For reasons of accessibility, books and journals will be of extreme importance in sourcing relevant information. These will present a variety of perspectives from diverse angles.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The Internet will be another major source of information. The WTO database will be exceedingly valuable in this regard. WTO publications and discussion papers will also be relied upon to show the WTO stance on the rise of RTAs. Case law concerning RTAs is scarce but will nonetheless be used to provide a clearer interpretation of the provisions of Article XXIV.

1.6 Referencing

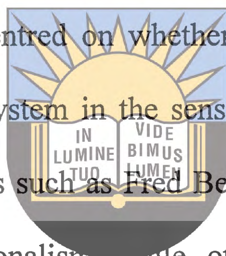
The referencing style used in this thesis is that of *Speculum Juris,* an accredited law journal jointly published by the University of Fort Hare, Nelson R. Mandela School of Law and the faculty of law, Rhodes University.

CHAPTER 2

REGIONAL TRADING AGREEMENTS

2.1 Introduction

Economic integration describes both a state of affairs and a process. The former refers to a fusion of formally separate national economies and the latter signifies the gradual elimination of economic frontiers between countries.[1] Regionalism has been defined as the "promotion by governments of international economic linkages with countries that are geographically proximate".[2] Much debate has been centred on whether Regional Trade Agreements[3] are supportive of the multilateral trading system in the sense of contributing to the overriding goal of trade liberalization.[4] Economists such as Fred Bergsten and Lawrence Summers are strong supporters of bilateralism/regionalism while others like Jagdish Bhagwati and Panagariya are sceptical about RTAs.[5] In addition, there are questions of whether the proliferation of RTAs is likely to increase the likelihood of trade wars between competing trade blocs.[6] Furthermore, it raises questions of whether it provides incentives for excluded countries to join existing RTAs or form new ones.[7]



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[1] Greenaway and Winters *Surveys in International Trade* (1994) 234.
[2] Grimwade *International Trade Policy: A Contemporary analysis* (1996) 232. Regionalism has also been defined as "any policy designed to reduce trade barriers between a subset of countries" regardless of whether those countries are actually contiguous or even close to each other. See Baldwin, Cohen, Sapir and Venables (eds) *Market Integration, Regionalism and the Global Economy* (1999) 8.
[3] Hereinafter RTAs.
[4] It is often contended that the recent proliferation of RTAs has disrupted the original equilibrium between multilateralism and regionalism that was established in the 1940s under the GATT and as such world trade has become fragmented. See Cho "Defragmenting World Trade" 2006 *Northwestern Journal of International Law and Business* 39 40.
[5] See Bergsten "Globalizing Free Trade". Available at http://www.jstor.org (accessed 06/06/08); Summers "Regionalism and the World Trading System". Available at http://www.kansascityfed.org/publicat/sympos/1991/s91summe.pdf (accessed 06/06/08) and Bhagwati, Krishna and Panagariya (eds) *Trading Blocs: Alternative Approaches to Analyzing Preferential Trading Agreements* (1999).
[6] Krugman "The Move towards Free Trade Zones". Available at https://www.kansascityfed.org/publicat/sympos/1991/s9/krugman.pdf (accessed 20-08-08). Brown et al argue that poorly designed and implemented RTAs lead to heightened tensions between countries and this increases the risk of inter-state conflict. They offer a few examples of conflict between members of RTAs, for instance, the outbreak of war in the Great Lakes with foreign involvement in the Democratic Republic of Congo between

RTAs represent growing numbers of agreements across regional groupings as well as across developed and developing countries. Increasingly, there is a variance in the form of these agreements from initial limited framework agreements to deeper partnership agreements going well beyond trade.[8] This is evidenced by a sharp growth in coverage beyond goods and services into areas such as mutual recognition, competition policy, movement of persons, investment and cooperation agreements, and a focus on trade management (or process) establishing procedures for joint exchange, coordination and other actions, as well as joint limitation on the use of trade restricting instruments such as tariffs.[9] Much of this is also reflected in the renaming of these agreements.[10]

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A variety of names has been given to regional integration agreements, namely: free trade areas, preferential trade agreements, trading blocs, regional trade associations, customs or economic unions and other combinations of similar words.[11] Theorists of economic integration typically rank them as follows:

1. Preferential trade agreements or arrangements or areas (PTAs)- in which signatories impose lower tariffs on each other's imports than on imports from third countries;
2. Free trade areas or agreements (FTAs)- involving not just lower but zero tariffs between member states, although typically not on all goods and services;

Angola, Namibia, Rwanda, Zimbabwe and Uganda-all members of the Common Market for Eastern and Southern Africa (COMESA), the Iraqi invasion of Kuwait and violent border clashes between Egypt and Sudan-all members of the Council of Arab Economic Unity. Even when war is costly and the option of a negotiated bargain exists, rival states can nevertheless go to war propelled by incentives to misrepresent or keep information private. See Brown, Shaheen, Khan, and Yusuf "Regional Trade Agreements: Promoting Conflict or Building Peace". Available at http:www.iisd.org/security/tas (accessed 20/11/08).

[7] Whalley "Regional Trading Agreements: Why so many, so fast, so different and where are they headed?" Available at http://ssrn.com/abstract=941445 (accessed 22/05/08).

[8] *Ibid.*

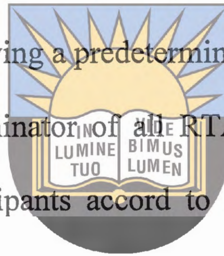
[9] *Ibid.*

[10] For example, the European Union's successive name changes from the Common Market to European Communities to the European Union describe its progressive evolution from a customs union to a single market.

[11] Hoekman and Kostecki *The Political Economy of the World Trading System: The WTO and Beyond* (2001) 347.

3. Customs Unions (CUs)- which are FTAs but with the same external trade measures for all member states;
4. Common markets (CMs)- which allow free movement of factors of production as well as products between member states;
5. Economic unions (EUs)- involving not only common factor markets and trade policies but also harmonization of other micro and macro economic policies.[12]

The term regional trade agreements (RTAs) cover all these agreements. It will be used to refer to agreements reached by countries whereby the participating countries align themselves with each other for the purpose of achieving a predetermined form of economic integration. It will be noted that the common denominator of all RTAs is the reciprocal nature of the preferential treatment which the participants accord to one another, as distinct from, for example, one way preferences involved in the generalized system of trade preferences (GSP) given to developing countries.[13] The term RTA will be used to refer to all trade agreements that deviate from the Most-Favoured Nation[14] principle; it is the general term used to refer to the whole spectrum of economic integration and will thus be used as such throughout this work. This chapter will discuss what RTAs are, how they work, reasons for their proliferation and how parties make the choice between free trade areas and customs unions.



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[12] Anderson and Blackhurst (eds) *Regional Integration and The Global Trading System* (1993) 4.
[13] The WTO agreements contain provisions that give developing countries special rights. These special rights are referred to as "special and differential treatment provisions". These provisions provide for instance, longer time periods for implementing WTO agreements and commitments or measures to increase trading opportunities for developing countries. Under the Generalized System of Preferences (GSP), developed countries offer non-reciprocal preferential treatment to products originating in developing countries. See provisions for Special and Differential Treatment in the WTO. Available at http://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm (accessed 29/08/09).

[14] Hereinafter the MFN principle or clause.

2.2 RTAs and *their modus operandi*

Regional trade agreements are normally considered to cover four types of arrangements: free trade areas, customs unions, common markets and economic unions. There are also preferential trading arrangements where preferences are reciprocal or granted on a non-reciprocal basis. The General Agreement on Tariffs and Trade[15] however only addresses two types of regional trade agreements in that it provides only for the formation of customs unions (CUs) and free trade areas (FTAs).

The GATT states that a CU must meet two basic criteria:

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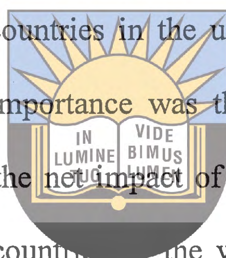
- The CU must eliminate duties and other restrictive regulations of commerce on substantially all the trade between the members; and
- Apply substantially the same duties and other regulations of commerce to non-members, that is, the CU must have a common external tariff and common trade policy measures.[16]

For a FTA, there is just one basic criterion, clearly similar to the first of the two which apply to a CU: its parties must eliminate duties and other restrictive regulations of commerce on substantially all trade between themselves regarding products originating in their territories.[17] These provisions are meant to ensure that the formation of FTAs or CUs do not unnecessarily distort the world's multilateral trading system and turn themselves into discriminatory entities that grant favours or preferential treatment to some members at the expense of others.[18] However, unlike some aspects of trade theory underlying the rationale for obligations in other areas of policy dealt with by the GATT, devising obligations relating to the individual RTA is complicated by the fact that the effect of the formation of a RTA on world welfare depends

[15] Hereinafter the GATT.
[16] Article XXIV: 5(a) of the GATT.
[17] Article XXIV: 5(b) of the GATT.
[18] The WTO Secretariat *Regionalism and the World Trade System* (1995) 5.

very much on the characteristics of each individual arrangement.[19] In the early 1950s Jacob Viner developed a theory on customs unions by which he introduced the concepts of trade creation and trade diversion.[20] Viner's concern focused on whether a customs union represented a move away from protection towards freer trade or a move towards protection.[21] In analyzing the economic consequences of a customs union, Viner concluded that two opposite forces would result from the creation of a customs union: a trade creating force generated by the elimination of a protection of domestic producers against their counterparts based in the other countries of the union and a trade diverting force resulting from the preferential access granted to partner countries in the union *vis-a vis* more efficient third country producers.[22] Of considerable importance was that Viner showed that no general presumption could be made regarding the net impact of a customs union on the economic well being of either the participating countries or the world as a whole.[23] Net trade and welfare effects depend on specific circumstances: from a global perspective, a customs union raised welfare to the extent that it created trade by diverting demand from higher cost domestic product to lower cost partner products and reduced welfare through the diversion of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[19] Sampson *Regional Trading Agreements and the Multilateral Trading system* (1996) 10.
[20] Viner "The Customs Union Issue" in Bhagwati, Krishna and Panagariya (eds) *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements* (1999) 105. Originally published in Viner *The Customs Union Issue* (1950).
[21] There is ample literature on the economics of customs unions regarding the question whether they may be welfare improving or reducing with an array of results, some contradictory. However, it is noted that most researchers use the work of Viner as the starting point. For more discussions on the issue of customs unions see the works of: Krugman "The move towards Free Trade Zones". Available at https://www.kansascityfed.org/publicat/sympos/1991/s9/krugman.pdf (accessed 20/08/08); Lloyd "Regionalism and World Trade". Available at http://www.oecd.org/dataoecd/30/33/34250566.pdf (accessed 25/03/09). For a review of studies or models investigating whether customs unions are trade creating or diverting, see Ghosh and Yamarik "Are Regional Trading Agreements Trade Creating? An application of Extreme Bounds Analysis". Available at http://www.sciencedirect.com (accessed 22/09/08). Cf Bond, Riezman and Syropoulous "A Strategic and Welfare Theoretic Analysis of Free Trade Areas". Available at http://www.biz.uiowa.edu/faculty/rriezman/papers/newftas8.pdf (accessed 27/08/09).
[22] Viner "The Customs Union Issue" in Bhagwati, Krishna and Panagariya (eds) *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements* (1999) 105.
[23] *Ibid.* Summers however asserts that when Union members are "natural trading partners", that is, the Union members already trade a lot with each other and are geographically proximate, the risk of trade diversion is minimal. See Summers "Regionalism and the World Trading System". Available at http://www.kansascityfed.org/publicat/sympos/1991/s91summe.pdf (accessed 06/06/08).

trade from lower cost foreign to higher cost partner sources.[24] Within the confines of Viner's model, it can not therefore be said that a customs union increases or reduces welfare. However, it is submitted that a customs union may be trade creating in some products and trade diverting in others.

The GATT rules on regional trade agreements are designed to minimise the possibility that non-parties to the agreements are adversely affected.[25] Thus, the guiding principle in the GATT is spelled out in Article XXIV which is the principal article dealing with the obligations relating to regional trade agreements. According to that article, 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.[26] The exception to non-discrimination for RTAs was controversial at its inception and has met with renewed controversy recently as many GATT members have increasingly exercised their rights under Article XXIV to negotiate RTAs. An analysis of how RTAs work could best be assessed based on how RTAs may affect the performance of GATT in the light of its pillars of reciprocity and non-discrimination as well as the extent to which they may affect the enforcement of multilateral obligations under the GATT.

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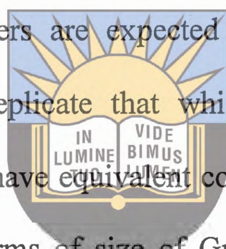
2.2.1 RTAs, Reciprocity and Non-Discrimination

A central pillar of the GATT system is the principle of Non-discrimination or the MFN Clause. According to this principle, signatories of the GATT undertake that they will treat each other equally, in that "any advantage, favour, privilege or immunity granted by any

[24] Viner 105. Wonnacott on the other hand argues that trade diversion is not necessarily welfare decreasing by definition. Instead he asserts that trade diversion may increase welfare for the diverting country and the world as a whole. Trade liberalization between partners in an RTA may lead to increased competition and specialization; firms can exploit economies of scale when they have a bigger market and the partner country may become the least cost supplier in this environment. Robinson however asserts that it is really a "new trade theory". See Wonnacott "Free Trade Agreements: For Better or Worse?" 1996 *American Economic Review* 4. See also Robinson and Thierfelder "Trade Liberalization and Regional Integration: The Search for Large Numbers". Available at http://www.ifpri.org/divs/tmd/dp/papers/tmdp34.pdf (accessed 08/06/09).
[25] Sampson *Regional Trading Agreements and the Multilateral Trading system* (1996) 20.
[26] Article XXIV: 4 of the GATT.

contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties...".[27] The MFN clause and its underlying obligation seeks to ensure that the commitments made in the course of trade negotiating rounds are uniformly applied by each country to its trading partners which contributes to securing and realising the economic benefits of international trade.[28] The critical question therefore is whether RTAs will interfere with the operation of a multilateral trading system that is built upon these pillars of reciprocity and non-discrimination.[29] RTAs adhere to the principle of reciprocity because partners are expected to exchange trade concessions.[30] However, this reciprocity does not replicate that which is found in multilateral trade negotiations.[31] Typically RTAs do not have equivalent concessions because they are formed between economies which differ in terms of size of Gross Domestic Product (GDP) and having widely different levels of trade barriers, inevitably the yields in terms of gains in market access for such economies cannot possibly be symmetric.[32]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In multilateral trade negotiations, reciprocity has a strong theoretical basis. Motivated by possibilities of improvements in terms of trade, countries try to maintain positive tariffs, creating a "prisoners' dilemma", whereby all countries would be better off if they cooperate

[27] Article 1.1 of the GATT.
[28] The WTO Secretariat *Regional Integration: Multilateral Rules and their Operation* (1995) 5.
[29] Critics of reciprocity worry that bilateral expectation of balanced and fair trade are too often subjective and too easily abused by protectionist interests. Maintenance of reciprocity may require retaliation to restore balance to the trading relationship. See Rhodes *Reciprocity, US Trade Policy and the GATT Regime* (1993) 2. Further, critics of reciprocal trade policies also fear that unilateral retaliations and enforcement of bilateral balances in trade cause conflict and encourage others to pursue similar trade restricting arrangements. For example, Anne Krueger argues that results oriented aggressive bilateralism has scope for big disruptions of the international trade system and little potential for enhancing the efficient flow of goods and services. See Krueger "Free Trade is the Best Policy" in Lawrence and Schultze (eds) *An American Trade Strategy: Options for the 1990s* (1990) 91. Proponents of reciprocity however contend that appeasing uncooperative behaviour encourages bilateral imbalances in market access and free riding on the GATT regime which can also have a detrimental effect on the collective interest of international trade cooperation when no other means of effective enforcement exists.
[30] *Ibid.*
[31] Bagwell and Staiger *The Economics of the World Trading System* (2002) 112.
[32] *Ibid.*

and reciprocate in lowering tariffs.[33] In RTA negotiations, unlike that of the multilateral trade system, the utility of reciprocity is not so clear because it furthers discriminatory tariff reductions.[34] If a RTA is being negotiated between a developing and industrial economy, reciprocity can be detrimental to the interest of the developing economy; the asymmetries in the size of the economies would therefore make it necessary for the smaller developing economy to make large scale concessions to achieve an agreement with the high income industrialized economy.[35] Therefore, RTAs have an indirect adverse effect on the operation of the principle of non-discrimination through discriminatory practices. For instance, several of the RTAs or countries which are members of RTAs operate additional preferences for non-member countries.[36]

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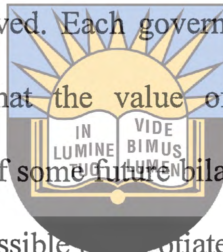
2.2.2 RTAs and Trade Negotiations

It is however probable that regional trade liberalisation may strengthen multilateral trade liberalisation in a number of ways. For example, by making member countries more competitive and internationally trade-oriented, protectionist pressures could be reduced.[37] RTAs can act as a model for multilateral trade liberalisation, especially in areas of non-tariff measures and services trade where the GATT record in achieving multilateral reduction has been less successful or difficult to achieve.[38] A workable system of international governance does not and cannot exist solely on the basis of global institutions because some issues are

[33] Das *Regionalism in Global Trade* (2004) 101.
[34] *Ibid.*
[35] Panagariya and Srinivasan argue that there has always been tension between the principle of non-discrimination and RTAs. However, this tension was not a serious political and economic issue as long as RTAs were limited to the EC and a handful of ineffective developing country arrangements. See Panagariya and Srinivasan "The New Regionalism: A Benign or Malign Growth". Available at http://www.bsos.umd.edu.com/panagariya/newregion/newregion.pdf (accessed 02/09/08).
[36] For example, the European Community (EC) maintains a multi-layer system of trade preferences which gives preferences to most of its trading partners outside the EC. The Canada-U.S. and Australia-New Zealand RTAs operate similar though less extensive multi-layer systems. See Lloyd "Regionalisation and World Trade". Available at http://www.oecd.org/dataoccd/30/33/34250566.pdf (accessed 25/03/09).
[37] *Ibid.*
[38] *Ibid.* For further reading see Trebilcock and Howse *The Regulation of International Trade* (1999) 130.

best dealt with regionally.[39] It is submitted that regionalism can set an example in the establishment and implementation of policies in areas not yet on the multilateral agenda. Thirdly, countries may also pursue unilateral liberalisation as they press for multilateral liberalisation in order to gain from the opportunities of trading with an expanding RTA.[40]

Bagwell and Staiger argue that any bilateral agreement that honours both the most favoured-nation principle and reciprocity leaves the welfare of any non-participating government unaltered.[41] Thus, when these principles are rigidly imposed, the scope for bilaterally opportunistic trade agreements is removed. Each government can then conduct its current trade concessions without the fear that the value of a concession received will be subsequently eroded as a consequence of some future bilateral agreement to which it is not a party.[42] On the other hand, when it is possible to negotiate a future bilateral agreement that is discriminatory, the welfare of non participating governments can be appropriated.[43] Bilateral opportunism and the associated fear of concession erosion are then potentially significant concerns for negotiating governments.[44] There has also been growing concern that regionalism might drain energy from multilateral negotiations. Kernohan and Edwards have noted that there is "an apparent weakening of appetite for globalisation" even among senior international policy makers, planners and strategists.[45] They attribute the collapse of the WTO talks on the Doha Round of Multilateral Trade Negotiations to this lack of enthusiasm for multilateral trade negotiations. Lastly, it is submitted that RTA formations may also strain resources in smaller countries with lower administrative budgets to meet the demand for both



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[39] Pronk "Globalization and Regionalism" in Teunissen (ed) *Regional Integration and Multilateral Cooperation in the Global Economy*. Available at http://www.fondad.org (accessed 08/07/09).
[40] *Ibid.*
[41] Bagwell and Staiger 113.
[42] *Ibid.*
[43] *Ibid.*
[44] *Ibid.*
[45] Kernohan and Edwards "The Fall of Doha and the Rise of Regionalism". Available at http://www.euactive.com (accessed 23/04/09).

multilateral trade and regional negotiations. In this instance it can be inferred that RTAs may negatively impact on multilateral trade negotiations despite the traditional benefits derived from regional negotiations.[46]

2.3 Factors influencing choice of a FTA over CUs

A FTA is a “designated group of countries that have agreed to eliminate tariff, quotas and preferences on most if not all goods among them”.[47] They however retain varying levels of tariffs and other barriers against the products of non-members. With regards to CUs, members go beyond removing trade barriers amongst themselves and set a common level of trade barriers *vis-a-vis* outsiders. Therefore, unlike a FTA, members of a CU have the same external trade measures or policies with respect to non-members.

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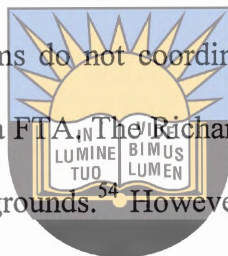
Maurice Schiff hypothesizes that as “multilateral trade liberalization proceeds and the number of RTAs increases, the ratio of free trade areas to customs unions increases”.[48] According to Schiff, CUs require more political integration among member countries than FTAs. First, CUs require supra-national bodies to negotiate the common external tariff and revenue-sharing mechanisms, which is not the case for FTAs.[49] Second, CUs are often pursued by countries in order to attain some political objectives, including the creation of regional public goods such as security and democracy or some other aspects of deep integration, while this is not the case with FTAs (or at least are much less since members of

[46] *Ibid.*
[47] Anderson and Blackhurst (eds) *Regional Integration and the Global Trading System* (1993) 5.
[48] Schiff “Multilateral Trade Liberalization, Political Disintegration and the Choice of Free Trade Agreements versus Customs Unions”. Available at www.worldbank.org/research/workpapers.nsf (accessed 20/08/08).
[49] *Ibid.*

FTAs must agree on exceptions and rules of origin).[50] Thus, CUs require a greater degree of compromise than FTAs and are thus more costly.[51]

Martin Richardson suggests that while CUs are preferable on welfare grounds, domestic interests seeking trade protection prefer FTAs because the endogenous external tariff is higher in this case.[52] The reason is that the common tariff creates an externality for firms lobbying in an individual country because when firms in industry 1 in country A lobby for protection, they benefit firms in industry 1 in country B. It is assumed that in the customs union, resistance to lobbying is greater because larger numbers of consumer voters are hurt by a tariff of a given size.[53] Since firms do not coordinate lobbying across countries, the resulting tariff is lower in a CU that in a FTA. The Richardson study suggests preference for CUs over FTAs on political economy grounds.[54] However one problem with CUs is that in setting a common external tariff, the member countries of the union will realize greater market power *vis-a-vis* the rest of the world than if they acted individually.[55] According to Kennan and Riezman, this eventuality does not arise with FTAs since each country continues to set tariffs independently.[56] The formation of a FTA improves the terms of trade and welfare of non-member countries because it creates an incentive for members to reduce their external tariffs. However, for member states, there are two opposing effects. In equilibrium,



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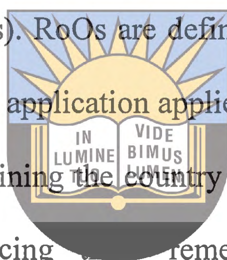
[50] *Ibid.*
[51] Jagdish, Krishna and Panagariya *Trading Blocs: Alternative approaches to Analyzing Preferential Trade Agreements* (1999) 262.
[52]Richardson "An Empty Proposition Concerning the Formation of Free Trade Areas". Available at www.business.otago.ac.nz/econ/research/discussionpapers/DP_0603.pdf (accessed 25/08/08).
[53] *Ibid.* Moreover, liberal-minded governments that join a CU may find it impossible to prevent domestic industries from seeking protection or block the imposition of protection. For example, it may be the case that certain countries did not use or make available contingent protection before joining the CU. See Hoekman and Kostecki *The Political Economy of the World Trading System: The WTO and Beyond* (2001) 360.
[54] Richardson "An Empty Proposition Concerning the Formation of Free Trade Areas". Available at www.business.otago.ac.nz/econ/research/discussionpapers/DP_0603.pdf (accessed 25/08/08).
[55] *Ibid.*
[56] Kennan and Riezman "Optimal Tariff Equilibria with Customs Unions". Available at http://www.biz.viowa.edu/faculty/riezman/papers/newfta8.pdf (accessed 25/08/08). The external policy bias towards protection will be weaker in a FTA because as members "compete" in their external trade policies they can not lobby for area-wide protection. See Hoekman and Kostecki 360.

their terms of trade *vis-a-vis* the rest of the world deteriorate and this is welfare-reducing.[57] At the same time, the liberalization of internal trade causes intra-union trade to expand and this is welfare-improving. As long as the economies of member countries are sufficiently large, the latter effect will dominate and the formation of a FTA will benefit both members and non-members.[58] These results contrast with the case of a CU, which will have a smaller external tariff reduction (or an increase in external tariffs) as a result of regional integration.[59]

Another factor in the comparison between CUs and FTAs is that FTAs generally require adopting complex rules of origin (RoOs). RoOs are defined as those "laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods...".[60] Determining the country of origin of a product is important for properly assessing tariffs, enforcing trade remedies such as antidumping and countervailing duties or quantitative restrictions, and for statistical purposes. Other commercial trade policies are also linked with origin determinations, such as country of origin labelling and government procurement regulations.[61] RoOs should not themselves create restrictive, distorting, or disruptive effects on international trade.[62] However, specifying RoOs can greatly increase the complexity of trade agreements.[63] RoOs prescribe the criteria used to define where a product was made. It is necessary to establish origin to prevent trade deflection, that is, imports entering into the FTA via the partner with the lowest



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[57] Kennan and Riezman "Optimal Tariff Equilibria with Customs Unions". Available at http://www.biz.viowa.edu/faculty/riezman/papers/newfta8.pdf (accessed 25/08/08).
[58] *Ibid.*
[59] *Ibid.*
[60] Uruguay Round of Multilateral Trade Negotiations "Agreement on Rules of Origin". Available at www.wto.org (accessed 25/04/08).
[61] Jones "International Trade and Rules of Origin: Implications of Globalized Manufacturing". Available at http://fpc.state.gov/documents/organization/108074.pdf (accessed 05/07/09).
[62] Agreement on Rules of Origin Article 2(a) (c).
[63] Jagdish, Krishna and Panagariya *Trading Blocs: Alternative approaches to Analyzing Preferential Trade Agreements* (1999) 545.

tariffs.[64] They are a powerful trade policy instrument arbitrating the market access of goods and guiding firms' outsourcing export and investment decisions around the world.[65] There are two types of RoOs, non-preferential and preferential RoOs. Non-preferential RoOs are used to distinguish foreign from domestic products for the purpose of applying several other trade policy instruments, such as anti-dumping and countervailing duties, safeguard measures, origin marking requirements, discriminatory quantitative restrictions or tariff quotas, and/or rules on government procurement.[66] Preferential RoOs are employed in RTAs and in the context of generalized systems of preferences (GSP) to define the conditions under which the importing country will regard a product as originating in an exporting country that receives preferential treatment from the importing country.[67] The economic justification for preferential RoOs is to curb trade deflection; to avoid products from non-preference countries being transhipped through a low-tariff RTA or GSP partner to a high-tariff one. RoOs are a feature of virtually all RTAs around the world, affecting the nearly fifty percent of world trade that is conducted on a preferential basis.[68] That RoOs can be employed for distributive, political economy purposes does not automatically mean they deflect resources from their most efficient uses. However, analysts of the potential trade effects of RoOs have produced resounding evidence that RoOs impose important administrative costs and increase production costs to parties applying them.[69] Both types of costs introduce protectionist biases that undercut the unfettered flow of commerce.[70]

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[64] De Melo "Regionalism and Developing Countries: A Primer" 2007 *Journal of World Trade* 360.
[65] Estevadeordal and Suominen "Rules of Origin in the World Trading System" Paper prepared for the Seminar on Regional Trade Agreements and the WTO 2003. Available at www.wto.org (accessed 25/08/08).
[66] *Ibid.*
[67] *Ibid.*
[68] *Ibid.*
[69] Sawyer holds a similar view on this point as he argues that RoOs are always somewhat costly to comply with and their increasing complexity allows countries to legally engage in a new form of protection because international trade law allows each country to specify rules of origin and countries have used this loophole as a disguised form of protectionism. See Sawyer "Nafta as a Means of Raising Rivals' Costs: A Comment". Available at http://www.springerlink.com (accessed 16/04/08).
[70] *Ibid.*

According to Rupa and Panagariya, RoOs may improve or worsen the joint welfare of members of a CU.[71] Secondly, the price distortion created by the RoOs has a direct bearing on the FTA endorsement. By increasing rents for the interest group that owns the intermediate input, the RoOs strengthen their political influence on the government.[72] Therefore there are situations when a member that unambiguously votes against the FTA in the absence of RoOs would switch its vote in their presence.[73] The preference for FTAs is a reflection of the characteristics of the current RTA race; the key attributes of this race appear to be speed, flexibility and selectivity.[74] The FTA is in most cases the configuration that best meets the needs of the countries which opt for them. FTAs allow for ambitions for preferential regimes while safeguarding a country's sovereignty over its commercial policies.[75]

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CUs share the FTA's objective of comprehensive trade liberalization among the parties; however, their formation is driven by policy objectives that together with their configuration requirements severely limit their flexibility as a trade policy instrument compared to FTAs.[76] Furthermore, while the parties to an FTA have in principle, full flexibility with regards to their individual choice of future FTA partners, participation in the CU, if played by the rules, limits the individual parties' choice for future RTA membership.[77] This is due to the fact that the proper functioning of the union requires that any agreement with third parties involve the

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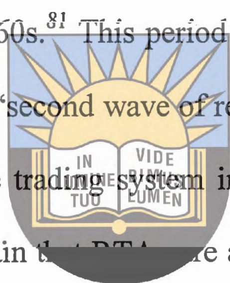
[71] Rupa and Panagariya "Free Trade Areas and Rules of Origin: Economics and Politics". Available at www.imf.org.external/pubs/ftl/WP/2003/WP03229.pdf (accessed 25/08/08).
[72] *Ibid.*
[73] *Ibid.*
[74] Fiorentino et al "The Changing Landscape of RTAs" Discussion Paper No 8 2006. Available at http://www.wto.org/english/tratop_e/region_e/region_e.htm (accessed 14/04/08).
[75] Crawford and Fiorentino "The Changing Landscape of Trade Agreements" Discussion Paper No 8 2005. Available at http://www.wto.org (accessed 18/04/08).
[76] Fiorentino et al "The Changing Landscape of RTAs" Discussion Paper No 8 2006. Available at http://www.wto.org/english/tratop_e/region_e/region_e.htm (accessed 14/04/08). For further reading see Barton "Expansion of the GATT/WTO Membership and the Proliferation of Regional Groups" in Barton, Goldstein, Josling and Steinberg (eds) *The Evolution of Trade Regimes: Politics, Law and Economics of the GATT and the WTO* (2006) 153.
[77] *Ibid.*

CU as a whole.[78] In the current trading climate of flexible and speedy RTAs, the preference of FTAs over CUs seems apparent and justifiable.

2.4 Recent Increase of RTAs

The growth of RTAs has been one of the major developments in international relations in recent years.[79] It appears however that regionalism is not a new concept to the international community. For as long as there have been nations with trade policies, they have discriminated in favour of some valued neighbours and against others.[80] There were widespread attempts at RTAs in the 1960s.[81] This period has been called the "first wave of regionalism" and the current period the "second wave of regionalism".[82] Before these periods there was a major fragmentation of the trading system into competing blocs, which in the standard view largely failed.[83] It is certain that RTAs are a major and perhaps an irreversible feature of today's multilateral trading system.[84] The number of RTAs as well as the world share of preferential trade has been steadily increasing over the past ten years. Sluggish progress in the multilateral trade negotiations under the Doha Round appears to have further accelerated the rush to forge RTAs.[85]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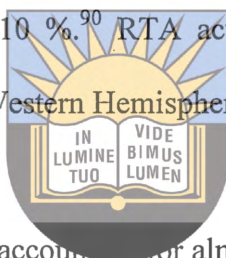
[78] Crawford and Fiorentino 7.
[79] Shiff and Winters *Regional Integration and Development* (2003) xi.
[80] Frankel, Stein and Wei *Regional Trading Blocs in the World Economic System* (1997) 1.
[81] *Ibid.*
[82] Bhagwati *The World Trading System at Risk* (1991) 65.
[83] Frankel, Stein and Wei 1.
[84] In today's world trading system, RTAs are a "major force". See Winters *Regionalism and the Next Round* (1998) 43.
[85] Crawford and Fiorentino "The Changing Landscape of Trade Agreements" Discussion Paper No 8 (2005). Available at http://www.wto.org (accessed 18/04/08). Crawford and Fiorentino's study points to four emerging trends in Regional trade integration:

- Countries are increasingly making RTAs a central objective of their trade policy which may take priority over multilateral trade objectives;
- RTAs are becoming more complex;
- The emergence of trade agreements between key developing countries may be evidence of strengthened South-South trading patterns; and
- That RTAs are generally expanding and consolidating with a growing number of cross-regional RTAs accounting for a large proportion of the total increase in RTAs.

The same points are reiterated in Brown, Shaheen, Khan and Yusuf "Regional Trade Agreements: Promoting Conflict or Building Peace. Available at http:www.iisd.org/security/tas (accessed 20/11/08).

The surge in RTAs has been on the increase since the early 1990s.[86] By December 2008, 421 RTAs had been notified to the GATT/WTO. Of these, 324 RTAs were notified under Article XXIV of the GATT 1947 or GATT 1994; 29 under the Enabling Clause[87]; and 68 under Article V of the GATS[88]. At that same date, 230 agreements were in force.[89] If the total number RTAs in force but not yet notified, those signed but not yet in force, those currently being negotiated, and those in the proposal stage were to be taken into consideration, the total figure would be close to 400 RTAs which are scheduled to be implemented by 2010. Of these RTAs, free trade agreements and partial scope agreements account for over 90%, while customs unions account for less than 10 %.[90] RTA activities have intensified across all regions of the world particularly in the Western Hemisphere and Asia-Pacific.[91]



Europe has the largest number of RTAs accounting for almost half of the agreements in force that have been notified to the WTO. The main regional groupings are the European Communities (EC) and the European Free Trade Association (EFTA).[92] Compared to Europe,

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[86] Laird "Regional Trade Agreements; Dangerous Liaisons". Available at www./atn.org.ar/achieves/documentacion/PAPER-Doc01%20.op_Laird_Regional%20trade%20agreement.pdf (accessed 12/09/08).

[87] The Enabling Clause is officially called the Decision on Preferential and more Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries of 28 November 1979 (L/4903). Available at http://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm (accessed 09/08/08). This Clause allows for differential and more favourable treatment by developed countries to products originating in developing countries without expecting the same or requiring that such treatment be accorded to other contracting parties. RTAs which do not fully fulfil the requirements of Article XXIV of the GATT can be notified under the Enabling Clause.

[88] The General Agreement on Trade in Services (GATS) applies to measures by member countries affecting trade in services. Article V of the GATS provides for the formation of RTAs among WTO members provided that such agreements:

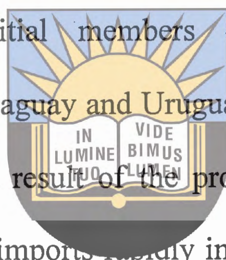
- Have substantial sectoral coverage; and
- Provide for the absence or elimination of substantially all discrimination between or among parties through the elimination of existing discriminatory and/or prohibition of new or more discriminatory measures.

Available at http://www.wto.org/english/docs_e/legal_e/ursum_e.htm#mAgreement (accessed 09/08/08).

[89] Statistics available at http://www.wto.org.org/english/tratop_e/region_e/region_e.htm (accessed 05/07/09).

[90] *Ibid.*
[91] *Ibid.*
[92] World Trade Organization Annual Report (2008) 70.

RTA dynamics in the western hemisphere are more varied in nature with several major players engaged in multifaceted RTA processes and not necessarily sharing similar objectives.[93] Latin American countries share a tradition of regional integration which is quite different from the recent and more market-oriented RTAs being pursued by Canada and the United States. The latter and Brazil are the vocal representatives of these differences in the troubled negotiations for the Free Trade Area of the Americas (FTAA) which aims at a continent wide FTA.[94] RTA developments in Latin America suggest increasing efforts towards consolidation and deepening of the network of RTAs among South and Central American countries.[95] The four initial members of Mercado Commún del sur (MERCOUSUR): Brazil, Argentina, Paraguay and Uruguay intra regional trade grew rapidly between 1990 and 1998 not only as a result of the process of integration itself but also because during this period demand for imports rapidly increased as Latin America emerged from the debt crisis of the 1980s.[96] Mercousur countries, especially Argentina and Brazil, have diversified their export structure and as a consequence they have been able to respond to the expanding domestic demand from regional partners in a variety of goods.[97] They have also concluded a framework agreement with three members of the Andean Community which aims at the gradual establishment of a FTA.[98]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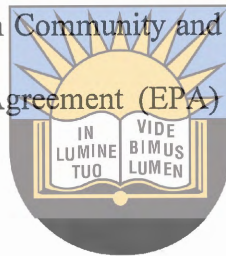
In North Africa and the Middle East, the most significant developments include the Agadir Agreement between Egypt, Jordan, Morocco and Tunisia which entered into force in 2007 and the Pan-Arab FTA notified to the WTO in 2007. RTA dynamics in Sub-Saharan Africa have focused mostly on the traditional concept of regional integration based on deeper

[93] Crawford and Fiorentino "The Changing Landscape of Trade Agreements" Discussion Paper No 8 (2005). Available at http://www.wto.org (accessed 18/04/08).
[94] *Ibid.*
[95] *Ibid.*
[96] United Nations Conference on Trade and Development "Trade and Development Report 2007: Regional Cooperation and Trade Integration among Developing Countries, Chapter IV". Available at http://www.unctad.org/en/docs/tdr2007ch4_en.pdf (accessed 23/10/08).
[97] *Ibid.*
[98] *Ibid.*

economic and political integration among geographically adjacent countries.[99] It seems that regional integration in Africa forms part of its efforts to improve its capacity to deal with the challenges of a globalized world.[100] Efforts at regional integration have included the establishment of the New Partnership for Africa's Development (NEPAD), the West African Economic and Monetary Union (WAEMU) and the Economic Community of West African States (ECOWAS).[101] Overall, the regional integration process is gaining depth, although progress is uneven and far from certain due to implementation problems arising from the complex web of overlapping RTA memberships. With the expiry of the WTO waiver for preferential trade between the European Community and the African, Caribbean and Pacific countries, the Economic Partnership Agreement (EPA) process has taken centre stage in African RTA developments.[102]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As the number of RTAs increases, there are signs of consolidation of existing agreements into larger trading arrangements in other regions of the world.[103] The deepening of existing RTAs that originally focused on "hard" trade restrictions like tariffs and quotas has seen their extension to "soft" restrictions such as health and environmental standards, to other product areas like services and intellectual property where trade policy is typically far more complex to describe or implement or to other issues that are not strictly within trade policy at all.[104] RTAs are being embraced by many WTO members as trade policy instruments and in the best of cases, as complementary to the MFN principle. Economic considerations are only one

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[99] World Trade Organization Annual Report (2008) 72.

[100] It has been suggested by Abdoulage Wade, the President of the Republic of Senegal that Africa is lagging behind on all indicators of economic growth and development even though it is being forced to operate in an international economic environment in which the rules governing economic competition are unfair. Address by Wade at the Annual World Bank Conference on Development Economics 2006. Available at www.worldbank.org (accessed 20/08/09).

[101] It is also hoped that these efforts together with other North-South initiatives such as, the African Growth and Opportunity Act (AGOA) and the Millennium Challenge Account (MCA) will spur economic growth and development in Africa. See Bourguignon and Pleskkovic (eds) "Growth and Integration" Annual World Bank Conference on Development Economics 2006. Available at www.worldbank.org (accessed 20/08/09).

[102] *Ibid.*

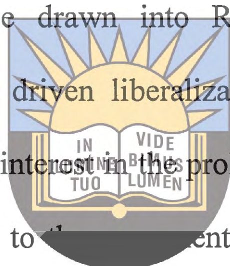
[103] For further reading see Bhala and Kennedy *World Trade Law* (1998) 160-161.

[104] Fernandez "Returns to Regionalism: An Evaluation of Non-Traditional Gains from RTAs". Available at http://papers.ssrn/sol3/papers.cfm?abstract_id=225749 (accessed 21/06/09).

facet of complex RTA strategies being pursued by individual or groups of countries which often include broader foreign policy aims such as political and security considerations.[105]

2.5 Reasons for RTA proliferation

RTAs provide an "outlet for working out divergent aims while at the same time providing a basis for moving toward a multilateral order that can meet the interests of all trading partners".[106] In this sense, some countries argue that their participation in RTAs provides a competitive spur to liberalization at the multilateral level by promoting trade liberalization on multiple fronts, while others may be drawn into RTAs to maintain market access opportunities in the absence of MFN driven liberalization.[107] During the course of the Uruguay Round there was considerable interest in the proliferation of RTAs, in particular, in identifying the intentions of the parties to the agreements.[108] Many of the observers of the international trading system, for example, queried whether the growth of regional trade agreements was born out of a frustration with the multilateral trading system, in particular, the slowness of governments to conclude the Uruguay Round, with parties viewing RTAs as alternatives to the multilateral system.[109] The alternative view was that the growth in regional



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[105] Laird "Regional Trade Agreements: Dangerous Liaisons". Available at www./atn.org.ar/achieves/documentacion/PAPER-Doc01%20.op_Laird_Regional%20trade%20agreement.pdf (accessed 12/09/08).

[106] Hart "A Matter of Synergy: The Role of Regional Agreements in the Multilateral Trading Order". Available at http://www.ubcpress.ca/books/pdf/chapters/regionalism/chapter1.pdf (accessed 17/11/08).

[107] Crawford and Fiorentino "The Changing Landscape of Trade Agreements" Discussion Paper No 8 (2005). Available at http://www.wto.org (accessed 18/04/08).

[108] Sampson 15. Schiff has noted that while there maybe many factors behind the recent proliferation of RTAs, some have explicitly stated goals whereas others represent objectives that can not be so publicly admitted. See Schiff and Winters *Regional Integration and Development* (2003) 6.

[109] Baldwin rejects the idea that the recent trend to regionalism is related to the dissatisfaction with the GATT system. Instead he cites a number of events, for instance, the history of bilateral trade talks between the US and Canada from 1854 coupled with the "Domino Effect" where the formation of one trade bloc generates pressure for others to join or form their own RTAs which in turn leads to a series of bilateral and plurilateral formation of RTAs. See Baldwin "A Domino Theory of Regionalism". Available at http://www.hei.unige.ch~baldwin/PapersBooks/dom old.pdf (accessed 06/06/08). Similarly, the same views are asserted by Barton, Goldstein, Josling and Steinberg who argue that the growth of RTAs may not be reflective of the problems with the multilateral trade system but may be part of a way that members resolve problems of political support for free trade in a democratically accepted way. See Barton, Goldstein, Josling and Steinberg *The Evolution of Trade Regime: Politics, Law and Economics of the GATT and the WTO* (2006) 174.

trade agreements was taking place for good economic and political reasons, which owed much to the past successes of the multilateral system embodied in the GATT.[110]

The critical question confronting the multilateral trading system prior to the conclusion of the Uruguay Round was whether it would be supported or challenged by the existence and proliferation of RTAs.[111] While in reality, no one single answer holds true for the various regional schemes now in place or under consideration, there are general trends which permit the drawing of some overall conclusions.[112]

The delay in concluding the Uruguay Round was a severe test of faith for many countries.[113] Achieving consensus on further multilateral liberalisation has proved to be an immensely burdensome process as some member countries seek to pursue their own trade agenda and are opposed to liberalising trade in areas where their producers are inefficient even if they receive

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[110] For a discussion of the progress of the WTO, see Schott *The World Trade Organization: Progress to Date and the Road Ahead* (1998) 5. Raimo has noted that literature on political, economic and cultural regionalism shows that this area of inquiry has increasingly become fragmented because of the underlying changes in international relations. Traditional views concerning the state-centric regional system are being challenged by the concentration of political and military power at the top as well as by transnational networks built around economic ties and cultural identities: that early post-cold war expectation that regions and regional concerts would form the foundation for a new international order have proved untenable. Instead regions appear to arise either through the dissemination of various transactions and externalities or as protection against the hegemony of capitalist globalization and greater power politics. See Raimo "Regionalism: Old and New". Available at http://www.jstor.org/stable/3186488.pdf (accessed 06/06/08).

[111] Baldwin "The Causes of Regionalism". Available at http://hei.unige.ch/~baldwin/AcademicPapers/AcademicPaper-files (accessed 20/08/08). Most studies assume that regionalism is potentially harmful and examine its impact on multilateralism. On a different note, Ethier argues that the effect goes from multilateral trade liberalization to regional integration rather than the opposite. See Ethier "Political Externalities, Non-discrimination and Multilateral World". Available at http://ssrn.com/abstract_id=333006 (accessed 20/10/08). An interesting point is also made by Baldwin and Thornton who assert that the world trade system is suffering from a massive proliferation of RTAs and the WTO is doing nothing about it. That the WTO has been an innocent bystander in the rise of regionalism; apart from gathering statistics and holding inconclusive discussions, the Organization has stood entirely apart from the rapid rise of regionalism driven forward by the uncoordinated actions of its members. See Baldwin and Thornton "Multilateralising Regionalism: Ideas for a WTO Action Plan". Available at http://www.graduateinstitute.ch (accessed 23/04/09).

[112] Sampson 17.

[113] A similar view can be found in Pal "Regional Trading Agreements and the Multilateral Trading System: An overview". Available at http://www.networkideas.org/feathm/may2004/survey_paper_RTA.pdf (accessed 01/07/09). Initially the GATT lacked enough provisions to make it sufficiently attractive to states with a predominantly agricultural base. As more and more nations gained their independence and joined the United Nations (UN), pressure grew to amend the GATT in order to make it more attractive to newly independent developing nations rather than allow them to pursue their respective agendas within the UN. See Subedi "The Notion of Free Trade and the First Ten Years of the World Trade Organization: How Level is the 'Level' Playing Field" 2006 *Netherlands International Law Review* 273 279.

a perceived corresponding concession.[114] This is especially true of those who were looking to a strengthening of the GATT system through a successful conclusion of the Round to consolidate their unilateral domestic economic reforms.[115] It is submitted that the results of these fundamental clashes of interests which exist between WTO members have again clearly demonstrated themselves by the developments in the Doha round whose negotiations have again collapsed.[116] In the absence of strengthened multilateral rules, regionally negotiated rules become a second best alternative.[117] With respect to the intentions of the regional arrangements, one of the most important positive signs is that many of the countries involved in RTAs are also active and committed participants in the multilateral system.[118] Second, countries forming regional arrangements clearly see no contradiction between pursuing a faster pace of liberalization through regional integration while pursuing more far-reaching global market openness through multilateral liberalization.[119] Another observation with respect to this general question is that the growth of regional trade agreements would become

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[114] Atta-Darkua "What Explains the recent increase in Regional Trade Agreements? Do you think this Development Will Hamper Further Multilateral Trade Liberalization within the WTO?" Available at http://www.essex.ac.uk/economics/EESJ/sp09/atta_246.pdf (accessed 02/07/09). Stoler also submits that decision-making was purposefully made difficult by those who negotiated the Uruguay Round Agreement Establishing the World Trade Organization because they did not want to see decisions taken easily or lightly that might undercut the results of the Round or undermine the sovereignty of important trading nations. See Stoler "Preferential Trade Agreements and the Role and Goals of the World Trade Organization". Available at http://www.iit.adelaide.edu.au/docs/PTAWTO_Perth04.pdf (accessed 01/07/09).

[115] Sampson 17.

[116] The same is supported by Taylor who argues that when the WTO does not deliver continued trade liberalization and growth opportunities, countries will continue seeking alternative paths to trade liberalization and trade reform. See Taylor "Regionalism: The Second Best Option" 2008 *Saint Louis University Public Law Review* 155 156.

[117] Mansfield and Bronson argue that RTAs can provide an institutional means of governing opportunism. Like alliances, RTAs are likely to promote relation-specific investments by private agents which in turn spur commerce among participants. See Mansfield and Bronson "Alliances, Preferential Trading Agreements and International Trade". Available at http://www.jstor.org/stable/pdfplus/2952261.pdf (accessed 30/05/09). Murphy also argues that regionalism and multilateralism can be mutually supportive strategies in the pursuit of not just free trade but internationalization of economic life. See Murphy "Regionalism and Multilateralism: Keeping up with the European Union" in Bagwell and Staiger (eds) *The Economics of the World Trading System* (2002) 79.

[118] *Ibid.*

[119] *Ibid.*

a threat to the multilateral system only if these groupings were to turn inward, erect new trade barriers and become hostile blocs.[120]

Integration is not only just driven by the desire to increase trade in goods but even more by increased cross border mergers and acquisitions, strategic alliances and other forms of foreign direct investments (FDIs).[121] Other reasons for RTA proliferation include the following;

- *The need for a path of least resistance*

The fact that there is an overwhelming majority of countries seeking MFN deviation through article XXIV may be an indication of the simplicity with which these agreements are concluded. Consequently, this proliferation of RTAs may be attributed to the difficulty in the multilateral negotiations conducted at the WTO, thus resulting in RTAs becoming an easy substitute for more difficult multilateral arrangements.[122] It is also worth noting that the number of new RTAs between developing and developed countries has grown substantially. These new agreements include bilateral agreements between one developing country and one of the world's largest and most powerful developed states, for instance, either the United States or the European Union.[123] Most of these agreements establish FTAs and have characteristics which have implications for developing countries: firstly, they allow for the

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[120] Chichilnisky argues that the determining factor is whether trade within the bloc is organized around traditional comparative advantages or around economies of scale. When RTAs are based on traditional comparative advantages, each regional market develops market power and incentives to impose tariffs on the rest of the world. Alternatively RTAs can be complementary to global free trade if the blocs are organized around the exploitation of economies of scale and based on knowledge intensive sectors. See Chichilnisky "Trade Regimes and the GATT: Resource Intensive vs Knowledge Intensive Growth". Available at http://mpra.ub.uni-muechen.de/8813/1/MPRA_page accessed 27/08/08).

[121] Hart"A Matter of Synergy: The role of Regional Agreements in the Multilateral Trading Order". Available at http://www.ubcpress.ca/books/pdf/chapters/regionalism/chapter1.pdf (accessed 17/11/08). For a division of the socio-economic and political drivers of RTAs in to "external" (drivers that originate from within a particular region) and "external" (drivers that originate from outside the region) see Brown, Shaheen, Khan and Yusuf "Regional Trade Agreements: Promoting Conflict or Building Peace". Available at http:www.iisd.org/security/tas (accessed 20/11/08).

[122] Matsushita "Legal Aspects of Free Trade Agreements in the Context of Article XXIV of the GATT 1994". Available at www.worldtradelaw.net.pdf (accessed 19/05/08).

[123] Taylor "Regionalism: The Second Best Option?" 2008 *Saint Louis University Public Law Review* 155 159.

greatest flexibility with regard to design and content of the RTA due to the weak WTO institution and rule based system and secondly, since FTAs entail the lowest level of economic integration each participating country retains more sovereign power.[124]

- *Economic benefits*

One of the major driving forces behind most RTAs is obviously the facilitation of economic benefits.[125] A prerequisite for concluding a RTA is the conception of a win-win situation, i.e. two or more countries recognize a window of opportunity to establish a reciprocal trade agreement that will benefit all the participating countries' economies.[126] RTAs can also lead to trade creation as the removal of trade barriers allows consumers and producers to purchase from the cheapest and most competitive source of supply which increases welfare.[127] Particularly with regards to trade in services, preferential access may confer long term advantages in a market and may enable a supplier to steal an irreversible march on the competition.[128]

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[124] *Ibid.* The same sentiments are expressed in Bhala and Kennedy *World Trade Law* (1998) 160.
[125] In her recent paper, Fernandez examines several possible benefits that RTAs confer on their partners including credibility, bargaining power, insurance and a mechanism for coordination. She concludes that RTAs can serve a useful economic purpose beyond the direct gains from trade liberalization by removing uncertainties and improving credibility and thus making it easier for the private sector to plan and invest. However, she notes that whether economies benefit from a particular RTA depends on the scope and coverage of its provisions, the nature of the enforcement mechanism, the circumstances in which the agreement can be amended and changes in the behavioural incentives for various agents in the economy that result from it. Fernandez "Returns to regionalism: An evaluation of non-traditional gains from RTAs". Available at http://papers.ssrn/sol3/papers.cfm?abstract_id=225749 (accessed 21/06/09).
[126] See Shiff's study where she examines the welfare impact of RTAs and the effect of structural and policy changes on RTAs in relation to how the RTA welfare is affected by higher demand for exports and the efficiency of production of the partners or the rest of the world. Amongst her findings, she concludes that an individual country benefits more from a RTA if it imports less from its partner countries and this results in important implications for its choice of partners. Shiff "Small is Beautiful: Preferential Trade Agreements and the Impact of Country Size, Market Share, Efficiency and Trade Policy". Available at http://paper.ssrn.com/sol3/papes.cfm?abstract_id=53860 (accessed 21/06/09).
[127] Abebe *Regional Trade Agreements and its Impact on the Multilateral Trading system: Eroding the Preferences of Developing Countries* (LLM thesis, University of the Western Cape) 20.
[128] Picker "Regional Trade Agreements: A Proposal for reform of Article XXIV to counter this Institutional Threat". Available at www.ssrn.com (accessed 22/05/08).

- *Widening scope of RTA negotiations through the inclusion of non trade issues*

It has been argued that the scope for RTAs would shrink as the tariffs negotiated under the WTO and the MFN-Principle are fairly low (approximately 3-4 %); thus the incentive for RTAs would diminish.[129] However, the introduction of non-economic matters in RTA negotiations, such as environmental and labour issues has attracted a great deal of interest to RTAs because they are broader in scope and are becoming the policy regime with the greatest influence on trade flows.[130]

- *Quicker to conclude*

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Proponents of regional integration usually point out that trade liberalization will often be achieved easier when negotiated between small groups of trading partners which may have a traditional long standing relationship creating a fruitful and trusting negotiating environment.[131] Since negotiations under the WTO are striving for consensus among all member states, they will generally stretch out over a considerably longer period of time than corresponding bilateral negotiations.[132] It is therefore plausible to conclude that RTAs

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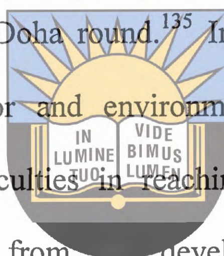
[129] Dynefors-Halberg *A legal and Political view on Regional Trade Agreements in the GATT/WTO* (LLM thesis, Gothenburg, 2007)21.
[130] Hallet "The New Regionalism and the Threat of Protectionism". Available at http://www-wds.worldbank.org (accessed 25/03/09). Cho has offered a good example of an RTA functioning as a regulatory platform to implement global standards: The North American Commission for Environmental Cooperation (CEC) which is the North-American Free Trade Area (NAFTA)'s environmental arm released a report titled "Implementing the Global Programme of Action in North America". The report contains recommendations on how to effectively implement international protocols on environmental protection such as the United Nations Global Programme of Action for the Protection of the Marine Environment from Land Based Activities. These multilateralization strategies can be regarded as positive harmonization in the sense that diverse regulations under RTAs are adjusted towards common regulatory references such as international standards. See Cho "Defragmenting World Trade" 2006 *Northwestern Journal of International Law and Business* 39 81.
[131] Herrman "Bilateral and Regional Trade Agreements as a Challenge to the Multilateral Trading System". Available at http://cadmus.iue.it/dspace/bitstream/81418089/1/LAW_2009-09.pdf (accessed 14/11/08).
[132] See generally Baldwin, Cohen, Sapir and Venables (eds) *Market Integration, Regionalism and the Global Economy* (1999) 218-219.

function as a short cut or a quick fix when multilateral negotiations are grinding to a standstill.[133]

- *RTAs as "The leading edge in multilateralism"*

RTAs can serve as learning devices with respect to multilateral liberalization by providing useful precedents, be it negative or positive.[134] Thus, RTAs can be used as "experimental laboratories" and experiences drawn from RTA negotiations could simplify difficult negotiations during, for example, the Doha round.[135] In addition, RTAs can more easily explore new territories, such as labor and environmental standards, than multilateral negotiations can because of the difficulties in reaching a consensus among all WTO members.[136] Furthermore, negotiators from less developed countries can use regional negotiations as training and preparation for the more complicated WTO negotiations.[137] Moreover, RTAs may serve as an "insurance policy" should multilateralism fail and the world economy slip into competing regional blocs.[138]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- *Political considerations*

Political considerations are also reported to be key to the decision to foster RTAs. Governments seek to consolidate peace and security with their regional partners, increase their bargaining power in multilateral negotiations by securing commitment first at regional

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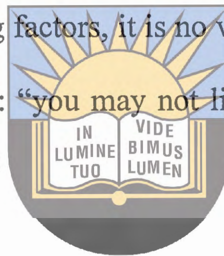
[133] *Ibid.*
[134] Krueger "Are Preferential Trading Agreements Trade Liberalizing or Protectionist". Available at http://www.people.fas.harvard.edu/~hiscox/krueger.pdf (accessed 01/07/09).
[135] Hoekman and Kostecki *The Political Economy of the World Trading System: The WTO and Beyond* (2001) 366.
[136] *Ibid.*
[137] *Ibid.*
[138] Switky *The Political Importance of Regional Trading Blocs* (2000) 18.

level or as a means of demonstrating good governance as well as to prevent backsliding on political and economic reforms.[139] They may also be used by the larger countries to forge new geopolitical alliances and cement diplomatic ties thus ensuring or rewarding political support by providing increased discriminatory access to a large market.[140] Increasingly, the choice of RTA partners appears to be based on political and security concerns thus potentially "undermining and diluting" the economic rationale which might be used in support of participation in RTAs.[141]

Because RTAs are driven by very strong factors, it is no wonder some commentators have in the past compared them to street gangs: "you may not like them but once they are in your neighbourhood it is safe to be in one".[142]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2.6 Negative effects of RTA proliferation

One of the major achievements of the multilateral trading system has been the "commitment of countries to maintain their markets relatively open and subject to transparent and mutually agreed measures and rules to facilitate international trade".[143] This has created conditions which ensure that trade relations remain stable and the risks of policy slippages and reversals

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[139] Similar points are made by Mansfield, Milner and Pevehouse. They argue that leaders in democracies have a strong incentive to join RTAs. In addition to the agreement spurring economic growth which is likely to benefit the median voter in a large selectorate, they also provide information to the electorate about the competence of the leadership. However, while democracies have a particular interest in regional agreements, the type of regional agreements they become parties to depend centrally on institutions and preferences within their countries. See Mansfield, Milner and Pevehouse "Democracies, Veto Players and the Depth of Regional Integration". Available at www.blackwell-synergy.com.integration.pdf (accessed 19/05/08) and Baldwin, Cohen, Sapir and Venables (eds) *Market Integration, Regionalism and the Global Economy* (1999) 218.

[140] *Ibid.*

[141] On the other hand, Andriamananjara asserts that incentives for countries to join trade blocs vary from country to country as well as for different types of RTAs; some may be established for political reasons more than for economic ones and vice versa. See Andriamananjara "On the Relationship between Preferential Trade Agreements and the Multilateral Trading System". Available at http://www.adb.org (accessed 20/10/08).

[142] Onguglo and Cernat *Development Issues Arising from Large Economic Spheres: Options for Developing Countries* (2000) 115.

[143] Drabek *Globalisation under Threat: The Stability of Trade Policy and Multilateral Agreements* (2001) xii.

to protectionism are minimised.[144] The gains from international cooperation generally rise with the number of countries included. The ideal international agreement is therefore often multilateral; however, in practice the model agreement is not multilateral but regional or bilateral.[145] Krueger argues that a long run breakdown of the open multilateral trading system could have a large negative impact on members of RTAs as well as the international economy.[146] As trade blocs expand, so does their market power and their ability to influence terms of trade in their favour. If successful this could be detrimental to the rest of the world if the bloc decides to increase tariffs against the rest of the world.[147] Even RTAs which offered large short term gains could result in long run deterioration of their members' welfare if their existence resulted in the tipping of the balance away from multilateralism towards regionalism.[148]

Those who are not in support of the idea of regionalism argue that it is "an active tool of trade discrimination and a divisive force draining scarce resources, attention spans and focus away from the WTO and multilateral negotiations".[149] Bhagwati calls this the "our market is large enough" syndrome, where a regional trade organization's market size may reduce the

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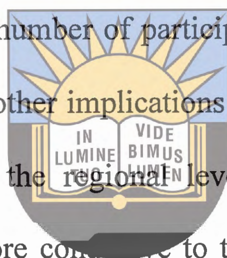
[144] *Ibid.*
[145] Kono "When do Trade Blocs Block Trade?" Available at http://www.blackwell-synergy.com/ (accessed 16/03/08).
[146] Krueger "Are Preferential Trading Agreements Trade Liberalizing or Protectionist?" Available at http://web.nps.navy-mil/~relooney/JEP_16.pdf (accessed 16/03/08).
[147] Hoekman and Kostecki 357.
[148] Krueger "Are Preferential Trading Agreements Trade Liberalizing or Protectionist?" Available at http://web.nps.navy-mil/~relooney/JEP_16.pdf (accessed 16/03/08). However, Hoekman and Kostecki submit that the impact of RTAs on members and non-members will depend on the type of agreement concerned, that is, whether it is a CU, a FTA or common market and on the degree to which intra-regional trade is liberalized. See Hoekman and Kostecki 351.
[149] Bagwell and Staiger 7. Baldwin and Thornton share the same view. They argue that discrimination is the "heart and soul" of regionalism. Economically, the discrimination part of discriminatory liberalization is inefficient, distorts prices and hinders the market's ability to allocate resources efficiently. See Baldwin and Thornton "Multilateralising Regionalism: Ideas for a WTO Action Plan". Available at http://www.graduateinstitute.ch (accessed 23/04/09). Further, Laird notes that at a more technical level, experience at the WTO shows that membership of RTAs is very demanding in terms of human resources. Preparation for and participation in meetings of various technical committees require considerable effort and such work is often carried out by the same staff that is responsible for the work of the WTO. See Laird "Regional Trade Agreements: Dangerous Liaisons". Available at www./atn.org.ar/archives/documentacion/PAPER_DOC 01%20.OP_Laird_Regional%20trade%20 agreement.pdf (accessed 12/09/08).

incentive for members to expand the RTA or pursue multilateral negotiations.[150] RTAs can also divert attention from multilateral negotiations.[151] Attention and focus becomes myopic regarding multilateral negotiations as the concerns of the regional trade negotiation take precedence in the minds of trade policy makers and politicians.[152] Furthermore, the benefits of regionalism may in future reduce the variance as well as the number of participants in multilateral negotiations.[153] The European Union (EU) is an example; rather than individual nations with differing objectives, priorities, and negotiating clout and perspectives participating at WTO forums, they present a common voice. The EU speaks for all its members and reduces the logistics and number of participants in discussions required at the WTO.[154] It is submitted that this poses other implications for the multilateral trading system, for example, a lack of agreement at the regional level can hold up agreement at the multilateral level.[155] Regionalism is more conducive to the easier route of negotiating with similar friends rather than the more demanding community of nations.[156] However, they may also entail playing "favourites" and risk reducing international relations to mutually destructive factionalism of the kind that was so dramatically evidenced in the 1930s.[157] As intra-bloc trade increases under the RTA, countries within the RTA become more likely to



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[150] Bhagwati "Departures from Multilateralism: Regionalism and Aggressive Unilateralism". Available at http://links.jstor.org (accessed 03/08/09).
[151] Schott "The Future of the Multilateral Trading System in a Multi Polar World". Available at http://www.iie.com (accessed 31/08/08).
[152] Bagwell and Staiger 28.
[153] *Ibid.*
[154] *Ibid.*
[155] This view is also supported by Woolcork. For example, the EU position on public procurement in the early phases of the Uruguay Round was shaped by internal debate over the scope and coverage of EU directives. This delayed somewhat the adoption of an EU position and thus the Uruguay Round. When the EU finally agreed on its internal position it then pressed for equivalent comprehensive coverage in the GATT. See Woolcork *Regional Integration and the Multilateral Trading System* (1996) 120.
[156] *Ibid.*
[157] Trebilcock and Howse *The Regulation of International Trade* (1999) 130.

raise trade barriers against parties outside the grouping.[158] These barriers are difficult to measure and quantify and thus are handy tools for protectionist interests within the RTA.[159]

Regionalism has had failures and is "susceptible to the manipulations of politics, misinformation, short sightedness and poor management".[160] As with any policy tool, regionalism and regional trade organizations are based on relatively sound logic and theory; however, reality is often greatly at variance with theoretical ideals.[161] The precedents set by RTAs are also, arguably potentially bad as well. One example is the exclusion of some agricultural products from trade liberalization under the Japan-Singapore Economic Partnership Agreement; specifically, the Agreement excludes cut flowers and ornamental fish, Singapore's principal exports of agricultural products to Japan, from the list of products imported under the terms of the agreement into Japan.[162] It has been reported that Japan is pushing for a similar exclusion in the negotiations with Australia, the Republic of Korea, and Mexico.[163]

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Futhermore, RTAs create a web of overlapping and inconsistent trade rules that complicate global sourcing and raise transaction costs, specifically when dealing with the issue of Rules of Origin (RoOs).[164] Jagdish Bhagwati has artfully described this as the 'spaghetti bowl.[165] RoOs are supposed to make sure that the preferential treatment under the FTA ends up in the

[158] Krueger "Are Preferential Trading Agreements Trade Liberalizing or Protectionist". Available at http://www.people.fas.harvard.edu/~hiscox/krueger.pdf (accessed 01/07/09).
[159] *Ibid.*
[160] *Ibid.* The same views are expressed in Frankel "Introduction to Regional Trade Agreements" in Baldwin, Cohen, Sapir and Venables (eds) *Market Integration, Regionalism and the Global Economy* (1999) 214.
[161] *Ibid.*
[162] Another example is the US predilection for side agreements on environment and labor standards. Having succeeded in embedding these in NAFTA, the US is now pursuing such agreements in other bilateral agreements and in the Free Trade Area of the Americas. See Nataraj "Regional Trade Agreements in the Doha Round: Good for India" http://www.adbi.org/files/dp67.regional.trade.agreement.doha.pdf (accessed 01/07/09).
[163] *Ibid.*
[164] Schott "The Future of the Multilateral Trading System in a Multi Polar World". Available at http://www.iie.com (accessed 31/08/08).
[165] Bhagwati and Krugger *The Dangerous Drift to Preferential Trade Agreements* (1995) 55

right pockets.[166] They are necessary to ensure that products which receive preferential treatment *de facto* originate in a partner country. This is a difficult task. In certain cases it is necessary to calculate the share of the value added to a certain product in the RTA member state. If the value added falls below, for example, 50% of the total value, the product does not qualify as having been produced within the preferential area and is therefore not eligible for preferential treatment. Now imagine a country which is a member of 10 RTAs with different RoOs, and the complexity becomes obvious.[167] Critics argue that RoOs are distorting and blatantly discriminatory and their overall impact on business is unclear.[168] In addition, RoOs complicate the production process since a producer who is interested in receiving preferential treatment must tailor the product for differential markets to be able to benefit from low/no tariffs.[169]

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Crawford and Fiorentino argue that developing countries in the third world may suffer from the widespread use of RTAs.[170] This is due to the fact that the web of several overlapping RTAs is considerably more complex and challenging than the multilateral agreement concluded at the WTO.[171] Developing countries have comparably smaller administrative budgets rendering successful negotiations and/or a successful utilization process difficult due to the lack of resources. This may have particular resonance in RTAs concluded between

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[166] Dynefors-Halberg *A legal and Political view on Regional Trade Agreements in the GATT/WTO* (LLM thesis, Gothenburg, 2007). Available at http://gupea.ub.gu.se/dspace/bitstream/2077/9873 (accessed 03/04/08).

[167] *Ibid.*

[168] Schott "The Future of the Multilateral Trading System in a Multi Polar World". Available at http://www.iie.com (accessed 31/08/08).

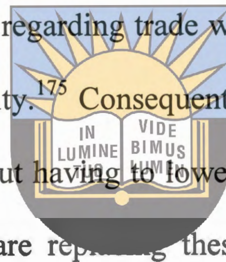
[169] *Ibid.*

[170] Crawford and Fiorentino "The Changing Landscape of Trade Agreements" Discussion Paper No 8 2005. Available at http://www.wto.org (accessed 18/04/08). For a comprehensive analysis of the GATT/WTO's legal relationship with developing countries see Hudec "Developing Countries in the GATT/WTO System". Available at http://local.law.umn.edu/uploads/images/5416/wto-trachtman.pdf (accessed 25/02/09).

[171] In a paper prepared by the ACP Group of countries, it was submitted that the existing GATT Article XXIV provisions do not take in to account the developmental aspects of RTAs entered in to between developed and developing countries; that is, countries with significant differences in levels of development, productive and export capacities and competitiveness. This they argue is due to the fact that Article XXIV was negotiated at a time in history when there existed very few if any North-South RTAs. See Submission on Regional Trade Agreements, Paper prepared by the ACP Group of States "Developmental Aspects of Regional Trade Agreements and Special and Differential Treatment in WTO Rules: GATT 1994 Article XXIV and the Enabling Clause, TN/RL/W/155, 28 April 2004. Available at www.wto.org (accessed 09/12/08).

developed and developing countries, or between low and high tariff countries.[172] Although the exporter facing the low MFN tariff may forego preferential treatment, the exporter exporting to the market where higher MFN tariffs exist has a greater incentive to comply with origin rules to secure the higher preference margin.[173]

It has also been argued that RTAs will replace the special and differential treatment provisions that are currently provided for by the WTO.[174] These provisions allow developed countries to disregard the MFN principle in favour of developing countries. In practice, the developed country eliminates all tariffs regarding trade with a developing country and at the same time declines its right to reciprocity.[175] Consequently, the developing country receives every beneficial trade concession without having to lower its tariffs on imported goods. The predicament with RTAs is that they are replacing these existing special and differential provisions and the effect of this is that the developing country trades in a non-reciprocal agreement for a less beneficial reciprocal preference.[176] The main reason for concluding an RTA is normally to obtain preferential treatment from one or more trading partners and consequently lock out non-members. However, non-RTA members will generally try to conclude an RTA with one of the members inside the RTA in order to benefit from the same preferences. This is called the 'Bandwagon Effect', and, according to the WTO Director-General Pascal Lamy, this means that "the more agreements you have, the less meaningful the preferences would be".[177]



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[172] Crawford and Fiorentino "The Changing Landscape of Trade Agreements" Discussion Paper No 8 2005. Available at http://www.wto.org (accessed 18/04/08).

[173] *Ibid.*

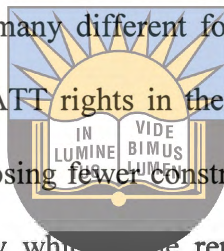
[174] *Ibid.*

[175] See provisions for Special and Differential Treatment in the WTO available at http://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm (accessed 29/08/09).

[176] Dynefors-Halberg 28.

[177] Lamy "Multilateral or Bilateral Agreements: Which way to go?" WTO News: Speeches- DG Pascal Lamy 10 September 2007. Available at http://www.wto.org/english/news_e/sppl_e/sppl53_e.thm (accessed 19/09//08).

Forming a trade bloc implies new or revised institutions possessing the ability to take on a whole range of issues under one regulatory body which makes countries more prepared to commit themselves to regional formations. The institutions in this case will play a powerful role by changing the incentives that member countries face.[178] In this instance, there is a possibility that RTAs can also undermine the basic aims of the multilateral trade order not only by adding preferential market access rights to the market access rights accorded multilaterally but also by eliminating in the relations between the regional partners, market access rights negotiated under the GATT.[179] The elimination of rights under the GATT through regional agreements can take many different forms. The parties to the RTA may explicitly agree to eliminate certain GATT rights in their relations with one another or to replace GATT rules by other rules imposing fewer constraints.[180] For example, the adoption of RTA-specific trade remedy rules by which trade remedies against RTA members are abolished outright or subjected to greater discipline.[181] A fairly large number of RTAs have adopted RTA-specific rules that tighten discipline in the application of trade remedies to RTA members. In the case of anti-dumping for example, some provisions increase *de minimis* volume and dumping margin requirements and shorten the duration for applying anti-dumping duties relative to the WTO Anti-dumping Agreement.[182] In a similar fashion, many of the provisions on bilateral safeguards lead to tightened discipline or reduce the incentives to take safeguard actions. They may require that safeguard measures can be imposed only during the transition period, have shorter duration periods and require compensation if put in place. Further, RTA provisions on global safeguards require that,



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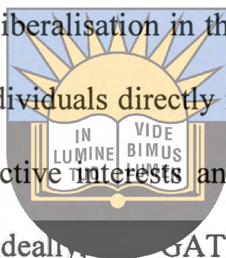
[178] Hallet and Braga "The New Regionalism and the Threat of Protectionism". Available at http://www-wds.worldbank.org (accessed 25/03/09).
[179] Roessler *The Relationship Between Regional Integration and the Multilateral Trade Order* (1993) 317.
[180] *Ibid.*
[181] Teh, Budetta and Prusa "Trade Remedy Provisions in RTAs". Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1019414 (accessed 21/06/09).
[182] *Ibid.*

under certain conditions, RTA partners be exempted from multilateral safeguard actions.[183] This clearly conflicts with multilateral rules which require that safeguard measures be applied to all sources of imports.

A regional trade agreement narrower in scope than the GATT legal system may also be conceived by its parties as an agreement regulating comprehensively their trade relations and therefore as an agreement replacing the GATT legal system as a whole, notwithstanding its narrower scope.[184] RTAs have certainly become a popular negotiation instrument that will continue to influence multilateral trade liberalisation in the decades to come as they cater to the personal and political interests of individuals directly involved in the negotiating process and can be tailored to members' respective interests and beliefs on how trade should be liberalised.[185] Roessler suggests that, ideally, the GATT should contain a clause which expressly preserves all substantive and procedural rights under the Agreement. Such a clause, which he refers to as a GATT *acquis* clause, will have numerous advantages both from the perspectives of parties to the RTAs and that of the multilateral trade order.[186]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2.7 Conclusion

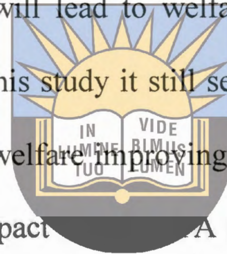
The huge acceleration by members of the WTO to become parties to RTAs all around the world has prompted much discussion on their driving factors and what they mean for the multilateral trading system. What is clear about these arrangements is that they are evolving: from the traditional RTA that was concerned mainly with the removal of tariffs to more complex efforts aimed at eliminating non-tariff barriers. The reasons why nations choose to participate in regionalism are manifold and diverse. They arise in both economic and political

[183] *Ibid.*
[184] *Ibid.*
[185] Atta-Darkua "What Explains the recent increase in Regional Trade Agreements? Do you think this Development Will Hamper Further Multilateral Trade Liberalization within the WTO?" Available at http://www.essex.ac.uk/economics/EESJ/sp09/atta_246.pdf (accessed 02/07/09).
[186] Roessler *The Relationship Between Regional Integration and the Multilateral Trade Order* (1993) 319.

realms; some more for political than economic reasons and vice versa. Three standard explanations for RTA proliferation that can be seen are that:

- They are quicker to negotiate and conclude;
- They have extended themselves to political, cultural, geopolitical and social realms and are not just for economic or financial benefit; and
- Tend to cover areas not yet on the multilateral trade negotiation agenda.

Despite the motivations for nations to embrace regionalism, it cannot be automatically assumed that being a party to RTAs will lead to welfare enhancements. After numerous studies which have been alluded to in this study it still seems apparent that there is no clear cut conclusive case whether RTAs are welfare improving or reducing. What can be deduced from the studies however is that the impact [illegible]A on world trade depends on specific circumstances; if RTAs can cooperate to effectively reduce barriers among their members, they could become important trade liberalizing tools. If they do not and instead become protectionist trade blocs, they will fail as liberalizing institutions.[187] More importantly, the proliferation of RTAs may pose dangers for the international trading community by a possible and gradual elimination of rights negotiated multilaterally in favour of those negotiated by a handful of trading partners. Especially contentious in this respect is the adoption of RTA-specific trade remedy rules which are not always in the best of cases consistent with that of the WTO. Regionalism therefore continues to have its detractors who express valid concerns while others have come to view regionalism as an acceptable compromise between the theoretical ideals of global free trade and reality.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[187] Bagwell and Staiger 24.

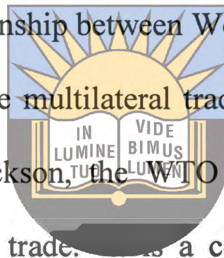
CHAPTER 3

HISTORICAL OVERVIEW OF RTAs

3.1 Introduction

A central objective of the GATT is to provide a set of rules under which countries can negotiate more liberal trade policies.[1] While the cornerstone of the General Agreement on Tariffs and Trade[2] is its Most-Favoured Nation clause,[3] the agreement permits certain deviations in Article XXIV of the GATT.[4]

For a proper understanding of the relationship between World Trade Organization[5] provisions on Regional Trade Agreements[6] and the multilateral trade regime, a historical overview of RTAs is necessary. As argued by Jackson, the WTO Charter must be regarded as the constitutional charter governing world trade.[7] It is a constitution that "imposes different levels of constraints on the policy options available to public and private leaders".[8] In this context Article XXIV could be construed as setting the multilateral constitutional limits within which RTAs can manoeuvre.[9] The WTO principles and rules assume the role of overriding constitutional disciples which structure the shape and contents of RTAs all with a view of supporting trade creation as building blocs for trade regulation and liberalization,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[1] Bagwell and Staiger "Multilateral Tariff Cooperation during the formation of Free Trade Areas". Available at http://www.jstor.org/stable/2527376 (accessed 20/08/08).
[2] Hereinafter the GATT.
[3] Hereinafter the MFN principle or clause.
[4] This is not however the only exception permitted by the GATT that allows members to deviate from the non-discrimination principle. Others include: Article XX of the GATT (general exceptions), Article XII (safeguard measures for the balance of payments), Article XXI (security exceptions) and Part IV (preferential treatment for developing countries). See Heiskanen "The Regulatory Philosophy of International Trade Law" 2004 *Journal of World Trade* 1 2.
[5] Hereinafter the WTO.
[6] Hereinafter RTAs.
[7] Jackson *The World Trading System: Law and Policy of International Economic Relations* (1998) 339.
[8] *Ibid.*
[9] *Ibid.* An opposing view is presented by Cass and Knoll who argue that the WTO is not a constitution by the standards of any conventional or historical definition nor should it be described as such. See Cass and Knoll *International Trade Law* (2003) 3.

while avoiding unnecessary trade distortions and diversions.[10] However, there is a growing perception that the exceptions and ambiguities which have permeated WTO rules have seriously weakened trade rules and make it difficult to resolve disputes to which Article XXIV is relevant.[11] Hallet and Braga have argued that GATT's effectiveness is complicated by the fact that many trade restrictions which are now commonly used do not properly fall under the disciplines of the WTO.[12] It is submitted that this allows countries to sustain a reasonably GATT consistent facade to the rest of the world while employing policy instruments that are essentially discriminatory and have a protectionist impact in practice.[13] It therefore becomes imperative to investigate the motives behind the inclusion of Article XXIV in the GATT.

3.2 Pre-GATT Preferences and MFN Response

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Economic conditions play a large role in the way in which different societies interact with one another. Not surprisingly therefore, economic activity throughout history has shaped the way the world is today. One notable period in world history which can be attributed to the way in which world trade is organized today is the period of colonialism.[14] The changes in the production and distribution of resources and trade among societies which colonialism brought about shaped world relations today.[15] Under colonialism, third world countries were

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[10] Cottier and Foltea "Constitutional Functions of the WTO and Regional Trade Agreements" in Bartels and Ortino (eds) *Regional Trade Agreements and the WTO Legal System* (2006) 43-44.

[11] MacMillan "Interpretation of Article XXIV: Does Regional Integration Foster Open Trade?" in Anderson and Blackhurst (eds) *Regional Integration and the Global Trading System* (1993) 9.

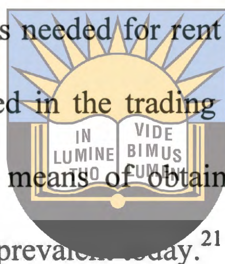
[12] Braga and Hallet "The New Regionalism and the Threat of Protectionism". Available at www-wds.worldbank.org (accessed 25/03/09). See also Cho "Breaking the Barrier between Regionalism and Multilateralism: A New Perspective on Trade Regionalism" 2001 *Harvard International Law Journal* 419 and Bhagwati *The World Trading System at Risk* (2001) 76-79.

[13] The same conclusions can be seen in Hallet and Braga "The New Regionalism and the Threat of Protectionism". Available at www-wds.worldbank.org (accessed 25/03/09).

[14] See Dirka "Colonialism and its Effects on Today's World". Available at http://www.geocities.com (accessed 01/06/09).

[15] In support of this view, Anghie submits that it is hardly controversial that one of the primary driving forces of colonialism was trade, with the expansion of colonial powers being a defining feature in the way international trade relations are organized today. The right to enter into territories to trade and the freedom of commerce was asserted powerfully even in Victorian times. Historically, much of the early trade had been conducted by the

obliged to produce for European countries' needs as well as their own in order to obtain currency.[16] This currency was needed to pay the taxes imposed on them by the colonizers and to buy European goods.[17] The spread of European Colonialism caused major disruptions in traditional food supplies in many parts of the non-European world while at the same time industrialization impoverished millions of European workers.[18] Explorations of Africa and other parts of the world became one way of increasing sustainability in Europe though the degree to which various areas of the world were absorbed into the European economy varied. As Europeans took over land which had previously not been owned by individuals and introduced property systems, money was needed for rent or purchase of land.[19] In this way, the European currency began to be used in the trading arena, replacing the barter system which had been commonly used as a means of obtaining goods.[20] Colonialism was the beginning of the world currency system prevalent today.[21]



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Long before the advent of the WTO and the GATT, trade agreements existed between nations within the same geographical area. The present day multilateral regime has its origins in the network of bilateral trade agreements that were negotiated among European countries during the mid 19th century.[22] However, the principles underlying the regimes were not an

British-India Company and the Dutch East India Company. See Anghie "Finding the Peripheries: Sovereignty and Colonialism in Nineteen-Century International Law". Available at http://cep.ise.ac.uk/pubs/download/dp08668.pdf (accessed 30/05/09).

[16] Dirka "Colonialism and its Effects on Today's World". Available at http://www.geocities.com (accessed 01/06/09).

[17] *Ibid.*

[18] Crossgrove, Esilman, Heywood, Kasperson, Messer and Wessen "Colonialism, International Trade and the Nation State" in Newman, Crossgrove, Kates, Mattews and Millman (eds) *Hunger in History: Food Shortage, Poverty and Deprivation* (1990) 227.

[19] *Ibid.*

[20] The same views are expressed in Subedi "The Notion of Free Trade and the First Ten Years of the World Trade Organization: How Level is the 'Level Playing Field'? 2006 *Netherlands International Law Review* 273 276.

[21] *Ibid.*

[22] Dirka "Colonialism and its Effects on Today's World". Available at http://www.geocities.com (accessed 01/06/09).

invention of the 19th century.[23] For several hundred years, nations entered into treaties of commerce with each other to protect and advance their commercial interests. One of the most elemental and long standing concerns of monarchs and their governments evident since the medieval times was to gain certain basic rights for their merchants when trading in neighbouring countries.[24] Their first aim was to protect their merchants and their property from arbitrary arrest and seizure. Accordingly, they sought assurance that their subjects would receive the same treatment under the laws of other states that the latter accorded their own merchants.[25] It is submitted that this can be regarded as the early manifestation of the notion of national treatment that plays a fundamental role in trade relations today. As trade by sea increased after the great explorations and navigational achievements of the 15th and 16th centuries by seamen, the terms on which foreign ships could enter ports to trade in cargo also became a major subject of treaties.[26] In these circumstances, trading nations sought to ensure that their ships and cargo were treated no worse than those of other foreign countries. Thus, clauses assuring the trading nation that it would receive the same treatment as other nations with regards to their goods began to appear in commercial treaties centuries before the MFN clause was elevated to a high principle of the modern multilateral regime.[27]

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[23] *Ibid.* Mansfield on the other hand points out that the analyses of the current spate of RTAs often draw on historical analogies to prior episodes of regionalism and such analogies can be misleading because the political settings in which these episodes arose are quite different from the current setting. His analysis of the historical evolution of RTAs describes four waves of regionalism that have arisen over the past two centuries; the first having occurred during the second half of the 19th century and largely a European phenomenon. See Mansfield and Milner "The New Wave of Regionalism". Available at http://www.jstor.org/stable/2601291.pdf (accessed 08/06/09).

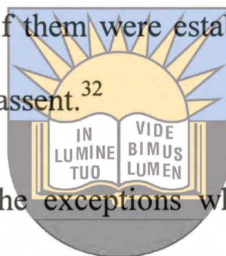
[24] During the mercantile phase of European expansion from about 1500 to 1800, merchants scoured the coast of Africa, Asia and the lands of South America in search of gold, spices, slaves and the conquest of existing trade routes. See Hoogvelt *Globalization and the Post Colonial World: The New Political Economy of Development* (1997) 17. The East India companies of the Dutch represented the most successful examples of merchant organizations in the early modern era. These companies exploited the possibilities of long distance trade in highly valued exotic goods from the Orient to Western Europe as well as seaborne traffic in the Asian trading world and eventually the potential for extracting taxes and tribute within Asia. See Neal "The Dutch and the East India Companies Compared: Evidence from Stock and Foreign Exchange Markets" in Tracy (ed) *The Rise of Merchant Empires: Long Distance Trade in the Early Modern World, 1350-1750* (1995) 195.

[25] *Ibid.*

[26] *Ibid.*

[27] *Ibid.*

Regionalism seemingly then appears to have always been with us.[28] Shiff and Winters also assert that RTAs have been around for years, for example, a customs union of the provinces of France was proposed in 1664; Austria signed free trade agreements with five of its neighbours during the 18th and 19th centuries and the colonial empires were based on preferential trade agreements.[29] Regimes such as empires, spheres of influence or unions of states, leagues, associations, pacts, councils etc have been apparent in different international systems.[30] Whalley however asserts that while this may be the case, these were only systems of trade preferences but not formal trade agreements as such.[31] They have at times played major roles in political history. Many of them were established for defensive purposes and not all of them were based on voluntary assent.[32]



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In order to assess the economics of the exceptions which Article XXIV provides, it is necessary to address the role of the unconditional MFN. The MFN principle dates back to over a hundred years although it was not codified in any multilateral treaty.[33] Customs Unions were part of international trade at the time though their existence was not regarded as an exception to the MFN principle.[34] MFN clauses in bilateral or plurilateral agreements

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[28] *Ibid.*

[29] Shiff and Winters *Regional Integration and Development* (2003) 4.

[30] Fawcett "Regionalism in World Politics: Past and Present". Available at http://www.garnet.eu.org (accessed 01/06/09).

[31] Whalley "Regional Trading Agreements: Why so many, so fast, so different and where are they headed?" Available at www.cigionline.org (accessed 28/04/08).

[32] The first major voluntary RTA appeared in the nineteenth century and included a customs union between Prussia and Hesse-Darmstadt. This was followed by the Bavaria Wurttemberg Customs Union, the Middle German Commercial Union, and the German Monetary Union. This wave of integration spilled over in to what was to become Switzerland when an integrated Swiss Market and political union was created in 1814. Furthermore, this also brought about economic and political union to Italy in the *Risorgimento* movement. See Mattli *The Logic of Regional Integration: Europe and Beyond* (1999) 1.

[33] In fact, it is submitted that the MFN clause featured in various guises in bilateral trade treaties since the 16th century but its inclusion in the GATT made it for the first time an obligation applicable to each signatory in its treatment of products of all other contracting parties.

[34] Reciprocal reduction of trade tariffs between states has a long history, for example:

- In Great Britain, there were proposals for a Union between England and Scotland during 1547-1548. In 1603 a Union of Crowns was established. Furthermore, the 1703 Act creating a Union of England and Scotland established a political as well as an economic union.
- In France, Colbert's plan in 1664 to unite all the provinces of the Kingdom into a customs union with internal free trade failed. However, all internal barriers were abolished by the Revolutionary government in 1789-1790.

assured each party that, if the parties to the treaty enter into any other agreements with third parties which provide more favourable treatment for the exports of those third parties, these more favourable conditions will be extended to the parties of the first agreement; that is, no other country will be treated more favourably.[35] Throughout Europe in the 19th and the 20th centuries, MFN clauses provided that these benefits should be extended unconditionally, or were interpreted in this manner, hence the unconditional MFN.[36] The United States on the other hand attempted until 1922 to apply the clause conditionally.[37] However, conditional and unconditional MFN do not sit well together. A third party which has a conditional agreement with one country and an unconditional agreement with another cannot satisfy the terms of both.[38] After accepting the recommendations of the United States Tariff Commission in 1922 the United States abandoned the conditional interpretation.[39] While Britain maintained that an explicit exception was required to exempt customs unions from MFN legitimately, other countries were not so demanding. What was generally required however was that the customs union be complete.[40] Bilateral agreements frequently provided for exemption from MFN for countries which had close affinity or which were contiguous, but these exemptions were

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- In Canada, Ontario, Quebec, Nova Scotia and New Brunswick agreed on free trade in foodstuffs and raw materials in 1850, as a single union, and a Reciprocity Treaty was concluded with the US removing all import tariffs on natural products of both nations in 1854. In 1867 the Canadian Confederation established free internal trade.
- In the United States of America, initially American colonies maintained separate tariff systems with a moderate number of duties; the Constitution adopted in 1789 barred the individual states from levying any duties on trade with other states.
- The German Zollverein laid plans for customs unions of German splinter states which at the time (1813-1815) were imposing customs duties at 38 frontiers; Prussia abolished internal tariffs in 1818 and through bilateral and plurilateral treaties in 1818-1828 established three customs unions. Eventually a treaty in 1833 established a single German Zollverein which was in effect from 1834 to 1871. These examples have been taken from The WTO Secretariat *Regionalism and the World Trading System* (1995) 6.

[35] Snape "History and Economics of GATT's Article XXIV" in Anderson and Blackhurst (eds) *Regional Integration and the Global Trading System* (1993) 275.
[36] *Ibid.*
[37] *Ibid.* for further reading on the decline of American leadership see Capling "The Multilateral Trading System at Risk: Three Challenges to the World Trade Organization" in Buckley (ed) *The World Trade Organization and the Doha Round: The Changing Face of World Trade* (2003) 40.
[38] Snape 275.
[39] Snape 279.
[40] *Ibid.*

minor in practice, at least until after World War I.[41] The British government, having participated in the substantial extension of preferences at the Ottawa Conference in 1932[42] and having justified such exemption from unconditional MFN on the basis of historical association, then argued that preferential agreements based on any other criterion were unacceptable.[43]

Partly in response to the experience of the 1930s, the post-world war II system established equal treatment of all partners as the fundamental principle of the trading system. Exceptions were permitted both on pragmatic grounds and for reasons of principle; among these exceptions was the ability to create trade blocs.[44] Aside from reinforcing existing colonial links this concession was little used at first but over time it contributed to the political reconstruction of Europe through the creation of the Benelux customs union in 1947, the European Coal and Steel Community (ECSC) in 1951 and the European Economic Community (EEC) in 1957.[45] The survival and apparent success of the EEC led to the "spurt" of regionalism between developing countries in the 1960s.[46] It is submitted that trade policy among developing countries had nothing to do with the past. While developed countries entered in to trade treaties to secure markets for their goods, the same appears to have arisen as a reflex response to what had been taking place in the international trade community at the

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[41] Snape 280.
[42] The Ottawa Conference, also known as the British Empire Economic Conference, was a conference of British colonies and their dominions held to discuss the Great Depression and ways of establishing a zone of limited tariffs within the British Empire.
[43] *Ibid.*
[44] Shiff and Winters 5.
[45] Hart, Mansfield and Milner all assert that the first serious wave of post war regionalism began in Europe in the 1950s. Integration in Europe flowed from a series of motives and circumstances; though commercial policy considerations were central, the political motives including security, historical sentiments, past conflicts and cold war anxieties played a large role and have continued to be critical to the success of European integration. See Hart "A Matter of Synergy: The Role of Regional Agreements in the Multilateral Trading Order". Available at http://www.ubcpress.ca/books/pdf/chapters/regionalism/chap1.pdf (accessed 17/11/08); and Mansfield and Milner "The New Wave of Regionalism". Available at http://www.jstor.org/stable/2601291.pdf (accessed 08/06/09).
[46] Panagariya "The Regionalism Debate: An Overview". Available at http://129.3.20.41/eps/it/papers/0309/0309007.pdf (accessed 14/11/08).

time.[47] However, RTAs between developing countries were largely protectionist and interventionist in the sense of trying to determine administratively which industries to have and where they should be located.[48] They involved numerous controls and restrictions on economic activity and by the late 1970s, the ineffectiveness of these RTAs had become apparent.[49] Effective RTAs therefore remained confined to Western Europe. Outside Europe, the American continent also had an extensive regional structure.[50] By the 1980s, considerable change in attitude towards international trade and cooperation started to take place. Led by the European Union's single market Programme a new wave of apparently more liberal RTAs emerged.[51]

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It has been argued that prior to World War II general MFN treatment was not applied. According to Mathis, the tension between existing patterns of preference and the re-establishment of MFN emerged as a first distinct issue in the discussions of the post-war planners.[52] The motive of determining preference by the use of MFN was attributable to a mix of economic, political and legal concerns.[53] Economically, much of the debate could be characterised in rather mercantilist terms as the external exclusionary effects of the British Imperial Preferences came to the centre of the issue as far as the US was concerned.[54] However, both countries also underpinned their Atlantic Charter discussions by the objective

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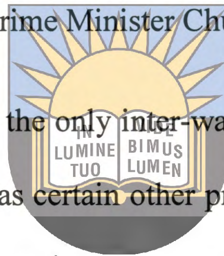
[47] Those countries that had been colonies had been taught by their colonizers that economic benefit was maximized by controlling trade and suppressing competition from alternative suppliers. These sentiments can be found in Hudec "Developing Countries in the GATT/WTO legal system". Available at http"//local.law.comn.edu/uploads/images/5416/wto-trachtman.pdf (accessed 25/02/09).
[48] *Ibid.*
[49] *Ibid.*
[50] Other regional blocs included the Arab League created in 1945 to link Arab states, the Anglo-American Caribbean Commission created in 1942, and a Treaty of Collective Defence for South East Asia signed in 1954 by Australia, France, New Zealand, Pakistan, the Philippines and Burma. See Reuter *International Institutions* (1958) 301.
[51] See Mansfield and Milner for a discussion of the waves of regionalism in Mansfield and Milner "The New Wave of Regionalism". Available at http://www.jstor.org/stable/2601291.pdf (accessed 08/06/09).
[52] Mathis *Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement* (2002) 13.
[53] *Ibid.*
[54] *Ibid.*

not to repeat the Versailles Treaty and the resulting inter-war experiences. The objective was to establish the credibility of MFN at the outset and to arrange a set of rules to lend support for its coherent application over time.[55] However, the ultimate direction in which the arrangement proceeded was markedly different from the outset as the US and Great Britain assumed a more activist role in framing the final conditions even while military conflict was still in progress.[56] The question of reintroducing non-discrimination to international trade came to the centre of the US-British relationship in what was cited as "the 1st definition of multilateralism" found in the August 1941 Atlantic Charter: the joint declaration of principles enunciated by President Roosevelt and Prime Minister Churchill.[57]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The Commonwealth Preference was not the only inter-war system that was to be affected by an emerging non-discrimination clause, as certain other preferential exceptions to MFN were also part of common practice.[58] In attempting to reconcile an emerging multilateral MFN principle with existing regional systems, Whidden conducted a survey of preferential systems used during the interwar period and then added an assessment as to which systems should be allowed to derogate from MFN.[59]

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[55] *Ibid.*
[56] *Ibid.*
[57] Mathis 21.
[58] *Ibid.*
[59] He developed the following categories;

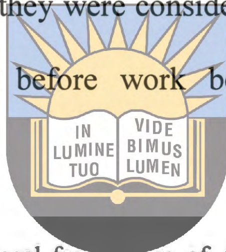
- Frontier traffic: the US and most other trading countries commonly recognized a 10 mile zone of exception along a border area, where to deny the exception would cause hardship on border commerce, for example, where a customs frontier passes through a city;
- Customs unions: recognising the standard US practice in its bilateral agreements to acknowledge exceptions in respect of advantages accorded in a customs union to which other signatories were (or would thereafter be) party. MFN would then be accorded to the newly-formed territory;
- Tariff assimilations in which the metropolitan area and its colonies are to be treated as a single unit;
- Colonial Preferences;
- Regional Preferences and low tariff clubs.

See Whidden "The Inter-war Experience: MFN and Preference". Available at http://dare.uva.nl/document/60566 (accessed 20/11/08).

In attempting to isolate the British and US attitude towards such agreements, Whidden concluded that no consistent practice appeared to evolve in either recognizing or refusing to recognize the granted preferences as exceptions to the MFN clause.[60] However, he did determine that there was a tendency to endorse arrangements when the countries concerned had some former historical relationship which was closer in the past than during the present.[61]

3. 3 The International Trade Organisation (ITO) negotiations for a regional exception

Despite the traditional acceptance of RTAs, the period between the two world wars cast RTAs in a particularly negative light as they were considered to be the contributing cause of the descent back in to war.[62] Even before work began on the International Trade



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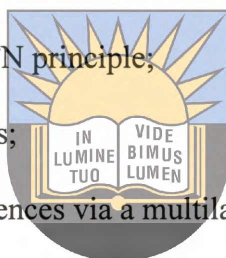
[60] *Ibid.*
[61] *Ibid.*
[62] Picker "Regional Trade Agreements: A proposal for Reform of Article XXIV to counter this Institutional Threat". Available at www.ssrn.com (accessed 22/05/08). The period between World War I (WWI) and World War II (WWII) was a political and economic disaster scarred by the Great Depression. The outbreak of WWI in 1914 interrupted what had been a period of growing worldwide economic prosperity with moderate tariffs and expanding world trade supported by a well-functioning international monetary system. After the shock of WWI, the international trade and payments system recovered very slowly during the 1920s. Most countries only gradually phased out wartime controls on trade, while tariff levels remained higher than before the war. The gradual restoration of the world economy was interrupted by a worldwide recession starting in 1929. This economic downturn was met by greater protectionism, which in turn further reduced world trade. Although monetary and financial factors were primarily responsible for allowing the recession to turn into the Great Depression of the early 1930s, the spread of trade restrictions aggravated the problem. The commercial policies of the 1930s became characterized as "beggar-thy-neighbour" policies. See Thrift and Pettigrew "The Multilateral Trade Regime: Which way Forward" *The Report of the First Warwick Commission* (2007). Available http://www.warwik.ac.uk (accessed 27/04/09). Blocking imports proved to be a futile method of increasing domestic employment because one country's imports were another country's exports. The combined effect of this inward turn of policy was a collapse of international trade and a deepening of the slump in the world economy. Many other countries also turned to discriminatory trade arrangements in the early 1930s, both for economic and political reasons. At a conference in Ottawa in 1932, the United Kingdom and its dominions particularly Australia, Canada, New Zealand, and South Africa agreed to give preferential tariff treatment for one another's goods. This scheme of imperial preferences involved both higher duties on non-British Empire goods and lower duties on Dominion goods. Nazi Germany concluded a series of bilateral clearing arrangements with central European countries that effectively created a new trade bloc, orienting the trade of these countries toward Germany at the expense of others. In Asia, Japan created the Greater East Asia Co-Prosperity sphere to extend its political and economic influence throughout the region and draw off trade for its own benefit. The outcome of these protectionist and discriminatory trade policies was not just a contraction of world trade, but a severe breakdown in the multilateral trade and payments system that the world economy had previously enjoyed prior to WWI and that had started to revive in the late 1920s. Official conferences and multilateral meetings, notably the World Economic Conference in 1933, offered pronouncements to resist protectionism, but failed to stem the spread of inward-looking anti-trade economic policies. See Irwin, Sykes and Mavroidis "The Genesis of the GATT". Available at http://faculty.chicagogsb.edu/workshops/international/pdf/Irwin,%20D.pdf (accessed 14/11/08). A similar historical account is provided in Jackson "The WTO Constitution and Proposed Reforms: Seven Mantras Revisited" in Cass and Knoll (eds) *International Trade Law* (2003) 68.

Organization[63], elimination of the fragmented world economy of the inter-war years, characterized by many preferential and regional systems, was one of the main economic goals of the post war period.[64] The United States in particular, was intent on the extension of the MFN principle as one device to ensure that the inter war period's harmful policies would not be repeated.[65] Both Dam and Jackson have stated that the primary goal which the US sought to accomplish in the ITO Charter and the GATT was the dismantling of trade preferences and preferential systems, particularly the Commonwealth system established by the 1932 Ottawa arrangement.[66] They suggest that the American goals were multiple:

- to obtain rehabilitation of the MFN principle;
- to promote the reduction of tariffs;
- to eliminate intra-imperial preferences via a multilateral framework; and
- to remove official trade barriers other than duties, etcetera.[67]



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With the case for non-discrimination so strong the question naturally arises as to why the founders of the GATT included provisions permitting customs unions and free trade areas. The Suggested Charter of the ITO in the first article proposed as its central tenet unconditional adherence to the MFN clause. Towards the end, Article 33 noted a lone exception permitting the union for customs purposes of any customs territory with any other

[63] Hereinafter the ITO.

[64] It has been suggested that the main trends in post war liberalization were as follows:
- The GATT process started when tariffs were very high worldwide;
- Rich nations liberalized much faster than poor nations in both the GATT process and RTAs;
- The liberalization focused on industrial goods in which two-way trade in similar goods was prevalent;
- The process of liberalization took forty years;
- Some sectors were excluded entirely and others experienced much less tariff cuttings;
- That tariff cuttings went hand in hand with multilateral liberalization; and
- Unilateral liberalization was important for developing nations from the mid 1980s.

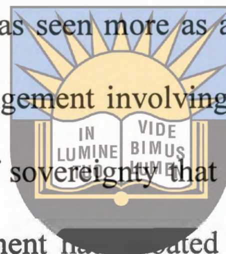
For more discussion on these trends, see Baldwin "Multilateralizing Regionalism: Spaghetti Bowls as Building Blocs on the path to global free trade". Available at http://www.socialsciences.com/data/articles/Document/5102007200.5717584.pdf (accessed 01/07/09).

[65] *Ibid.*

[66] As cited in Mathis *Regional Trade Agreements in the GATT-WTO Article XXIV and the Internal Trade Requirement* (2002) 33.

[67] *Ibid.*

customs territory.[68] Notably, this customs union provision was not grouped with the MFN clause in Art 1; rather, it was part of a pro forma article defining the term 'customs territory'.[69] Customs territories, not countries, would be the constituent bodies of the ITO, and the wording was intended to clarify that the charter would apply to countries with separate tariff structures, even if they were under common sovereignty. Traditionally, customs unions had been treated as distinct territorial entities; because of their political status MFN commitments did not apply to them.[70] At the time there was no case of a customs union on record that was not accompanied or quickly followed by complete political and economic union. Customs integration therefore was seen more as a question of frontiers and customs jurisdiction than as a commercial arrangement involving discrimination in the treatment of trade.[71] This was simply an exercise of sovereignty that did not require an exception to the MFN principle. The US State Department had advocated giving the ITO broad authority to discipline even customs unions.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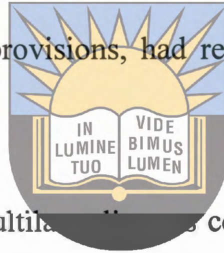
The US and the British proposals for the MFN clause followed the lines of agreement that had been settled between them in preparation for the UN Conference on Trade and Employment (1946).[72] This compromise provided for a standstill position for listed annexed preferences including the Commonwealth preferences[73], as provided for and finally incorporated into GATT Art 1:2.[74] All future preferences as within the annexed systems would be subject to MFN. In addition, the US submitted draft proposals for what would later become GATT Article XXIV. The clause followed the pattern established according to its

[68] Chase "Multilateralism Compromised: The Mysterious Origins of the GATT Article XXIV" 2006 *World Trade Review* 1 3.
[69] *Ibid.*
[70] *Ibid.*
[71] *Ibid.*
[72] *Ibid.*
[73] These also included preferences in force in the French Union, preferences given by the Benelux Countries and by the United States, those exchanged between Chile and its neighbours and the preferences granted by the Lebanon-Syrian Customs Union to Palestine and Transjordan.
[74] *Ibid.*

own bilateral MFN agreements based on to the US Reciprocal Trade Agreement Act.[75] As such, the US opening position recognized a granted exception from MFN for customs union territory formations.

Even during the early years of the inception of Article XXIV, a number of concerns were raised by delegates. It is reported that some delegates expressed the view that the Article XXIV provisions exempting regional trade agreements from the application of the MFN and non-discrimination principles were in need of review.[76] They argued that the widespread use of Article XXIV, and frequent failure to reach consensus on whether particular arrangements were in conformity with the relevant provisions, had resulted in imbalances in rights and obligations among contracting parties.[77]



One delegation said that in its view, multilateralism as conceived by Article I of the GATT had been distorted by exceptions and the anomalous application of Article the XXIV provisions.[78] According to the delegation, countries were evading the provisions of Article I by entering into RTAs that did not meet the requirements of Article XXIV, but which other contracting parties had little option but to accept.[79] This situation was prejudicial to the interests of developing countries who found that the value of concessions made to them was impaired and that the margins of preference they enjoyed were eroded or nullified by benefits exchanged between parties to such agreements.[80] The adaptation of the international trading system to the future required that the provisions of Article XXIV be interpreted in such a way

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[75] *Ibid.*
[76] The WTO Secretariat "Proposals for review and background information on certain GATT Articles" MTN.GNG/NG7/W2, 6 May 1987. Available at http://gatt.stanford.edu (accessed 20/04/09).
[77] *Ibid.*
[78] Group of Senior Officials, Draft Report to the contracting Parties, Spec (83)58 7 November 1985. Available at http://gatt.stanford.edu (accessed 20/04/09).
[79] *Ibid.*
[80] *Ibid.*

that it could not be used to provide cover for agreements which did not comply with all its requirements.[81]

Bhagwati has also noted a "tension between intention and reality" which goes against what the original drafters of Article XXIV intended and sketches briefly the important respects in which the original intention of Article XXIV was reasonably clear but was occasionally violated in spirit to a point were it was observed by others that it was the beginning of the breakdown of the GATT's legal discipline.[82] For instance, with regard to the elimination of internal barriers down to hundred per cent, there was enough scope within the language of Article XXIV: 8 for its intent to be successfully avoided. In his view, skilful lawyers and representatives of governments could easily manipulate most of the concepts embodied in the provision.[83] It also seems that one of the reasons for allowing this deviation from the MFN principle was to accommodate the reality prevailing at the time. Many countries would not have joined the GATT if it had prohibited future RTAs among neighbours.[84] Few therefore wonder that Article 1 paragraph 2 of the GATT 1947 had explicitly exempted from the MFN requirements all RTAs that were in force at the time the GATT came into effect.[85] However these were capped by a requirement that they could not be raised above the existing levels and their significance has been steadily reduced over the past decades by successive rounds of tariff reductions.[86]

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It is noteworthy that a major part of Article XXIV referred throughout to customs territories and that each customs territory shall, exclusively for the purpose of the GATT be treated as though it were a contracting party. This follows from the stipulation that "customs territory"

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[81] *Ibid.*
[82] Bhagwati *The World Trading System at Risk* (1991) 65.
[83] *Ibid.*
[84] Das *Regionalism in Global Trade* (2004) 97.
[85] *Ibid.*
[86] The WTO Secretariat *Regionalism and World Trade* (1995) 7.

shall be understood to mean any territory with respect to which separate tariffs...etcetera are maintained for the substantial part of the trade of such territory with other territories.[87] Why then were free trade areas permitted MFN deviation? The expression "free trade area" was first introduced at the United Nations Conference on Trade and Employment held in Havana from November 1947 to March 1948.[88] The definition of the concept must therefore be sought wholly within the context of the Havana Charter. However, according to Chase, the "GATT treaty loophole for free trade areas in Article XXIV has puzzled and deceived prominent scholars, who trace its post-war origins to US aspirations to promote European integration and efforts to persuade developing countries to endorse the Havana Charter".[89] Chase asserts that the true motive behind the FTA inclusion in Article XXIV was a proposed FTA between USA and Canada.[90] According to her, US policy makers crafted the controversial provisions of Article XXIV to accommodate a trade treaty they had secretly reached with Canada. As a result, the free trade area exemption was embedded in the GATT regime.[91]

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According to Odell and Eichengreen the key to understanding the Havana Charter lies in "the story of US concessions to keep Britain from exercising the imperial option".[92] If British officials thought the ITO would overly constrain policies considered necessary to maintain full employment, they could abandon the talks and instead deepen links with the Commonwealth. By comparison, "the United States did not have any obvious regional

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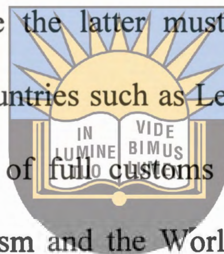
[87] Article XXIV: 1 and XXIV: 2 of the GATT.
[88] The WTO Secretariat *Regionalism and the World Trading System* (1995) 8. The proposal for the inclusion of free trade areas was introduced by Lebanon and Syria with the support of several developing countries on the grounds that avoidance of the requirement for a common external trade policy required for customs unions was better suited to the needs of integration among developing countries. The proposal championed by France was accepted as a means of blunting developing country demands for a legitimization of preferences.
[89] Chase "Multilateralism Compromised: The Mysterious Origins of the GATT Article XXIV" 2006 *World Trade Review* 1 8.
[90] *Ibid.*
[91] *Ibid.*
[92] Odell and Eichengreen "The United Nations, the ITO and the WTO: Exit Options, Agent Slack and Residential Leadership" in Krueger and Aturupane (eds) *The WTO as an International Organization* (1998) 183.

alternative for achieving its trade-related geopolitical goals".[93] In this sense, the exceptions for customs unions and free trade areas were part of the "embedded liberal" compromise to reconcile US multilateral principles with Britain's and Europe's need for domestic stability.[94] A related claim is that US officials conceded to free trade areas because they wished to encourage European integration rather than thwart it.[95] If the Havana Charter had raised too many obstacles to regional integration, Odell and Eichengreen suggest that European countries would have spurned the ITO.[96] Bhagwati concludes that "US tolerance of free trade areas seems to have been motivated by a presumption that European stability would be aided by economic integration and therefore the latter must be supported".[97] Other accounts emphasize pressure from developing countries such as Lebanon, Syria, Argentina, and Chile to permit regional arrangements short of full customs union.[98] The WTO advances this explanation in its report on "Regionalism and the World Trading System".[99] In this vein, Goldstein and Gowa[100] argue that the United States accepted free trade areas to make its commitment to an open, rule-based trading system credible.[101] For small countries anxious about the possibility of opportunistic US behaviour, the option to band together in trading blocs represented an 'insurance policy' to counter US power.[102] Thus, the US concession on free trade areas was part of the package of concessions granted to developing countries at Havana.[103] It has also been suggested that the inclusion of FTAs in Article XXIV was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[93] *Ibid.*
[94] Ruggie "International Regimes, Transactions and Change: Embedded Liberalism in the Post-war Economic Order" http://www.jstor.org/stable/2706527 (accessed 23/04/09).
[95] Odell and Eichengreen 183.
[96] *Ibid.*
[97] Bhagwati 65.
[98] Chase "Multilateralism Compromised: The Mysterious Origins of the GATT Article XXIV" 2006 *World Trade Review* 1 8.
[99] The WTO Secretariat *Regionalism and the World Trading System* (1995) 8-9.
[100] Goldstein and Gowa "US National power and the Post-war Trading Regime" 2002 *World Trade Review* 164
[101] *Ibid.*
[102] *Ibid.*
[103] *Ibid.*

supposed to complement the relatively complicated process of forming a Customs Union with a less complicated alternative, namely a FTA.[104]

The introduction of MFN with existing preferences laid the foundations for future growth of world trade on the basis of non-discrimination.[105] From the beginning though it is apparent that the US was vigorously opposed to preferences; it accepted customs unions in which the participating countries would adopt a common trade policy including a common external tariff.[106] A provision for customs unions was thus included in the US proposals of 1945, followed by the introduction of the concept of free trade areas during the United Nations Conference on Trade and employment held in Havana from November 1947 to March 1948. This launched the negotiations that eventually led to the inclusion of Article XXIV, via the draft charter of the ITO into the GATT and has remained essentially unchanged since.[107]

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3.4 Conclusion

RTAs have been a continuing part of the world trading landscape for several centuries. It appears however that regionalism re-emerged in the 1950s as one of the most important developments in the world trading system. The 1950s saw the evolution of more highly effective RTAs than those that had emerged prior to WW1.[108] In the wake of European expansion regionalism branched out into countless new and exotic trade preferences inciting

[104] The inclusion of the concept of free trade areas attracted great support from several developing countries on the grounds that avoidance of the requirement for a common external trade regime made free trade agreements better suited to the needs of integration among developing countries see The WTO Secretariat *Regionalism and the World Trading System* (1995) 8.
[105] *Ibid.*
[106] *Ibid.*
[107] There have been some clarifications on some of the provisions of Article XXIV over time but the content remains the same.
[108] Hart "A Matter of Synergy: The Role of Regional Agreements in the Multilateral Trading Order". Available at http://www.ubcpress.ca/books/pdf/chapters/regionalism/chap1.pdf (accessed 17/11/08).

major regional formations across the world.[109] Apart from European integration, the Americas have seen a proliferation of effective RTAs as well, for example the NAFTA. The success of these trade blocs led to the "spurt" of regionalism between developing countries and created a new wave of bloc formations that have become more liberal.[110] It is trite that prior to the GATT the world trade system was characterized by many preferential and regional trading arrangements. Some feared that this would lead to greater protectionism than the period following the two world wars.[111] The need to reconcile these differences necessitated the establishment of a multilateral framework that would ensure that the harmful policies of the inter-war period would not be repeated. However, what came to the fore was that many countries would not join the GATT if it prohibited future RTAs between neighbours or countries that were politically connected. What then emerged was a compromise between the US and the British in the introduction of an application of the MFN principle which exempted existing preferences. The success of this historical milestone in trade history laid the foundations for the future growth of world trade based on the principle of non-discrimination.[112]

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Nonetheless, the exemption of RTAs has created concern that the world trade system may gravitate towards regional blocs. In a speech delivered by Peter Sutherland, Director General of the GATT in 1994, he opined that quick and comprehensive implementation of the WTO Agreements will ensure that regionalism and multilateralism continue to be partners and not opponents.[113]

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[109] Mansfield and Milner "The New Wave of Regionalism". Available at http://www.jstor.org/stable/2601291.pdf (accessed 08/06/09).

[110] *Ibid.*

[111] Thrift and Pettigrew "The Multilateral Trade Regime: Which way Forward" *The Report of the First Warwick Commission* 2007. Available http://www.warwik.ac.uk (accessed 27/04/09).

[112] Ruggie "International Regimes, Transactions and Change: Embedded Liberalism in the Post-war Economic Order" http://www.jstor.org/stable/2706527 (accessed 23/04/09).

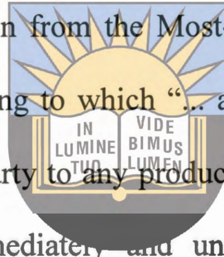
[113] Sutherland "Regional Integration and the World Trade Organization: Partners not Opponents" GW/03 7 July 1994 http://gatt.stanford.edu (accessed 20/04/09).

CHAPTER 4

THE SUBSTANTIVE AND PROCEDURAL LAW OF ARTICLE XXIV

4.1 Introduction

When discussing regional trade agreements from a legal perspective, Article XXIV of the General Agreement on Tariffs and Trade[1] of 1994 takes centre stage. For the most part of the GATT's first decade of existence, the GATT rules on regional trade agreements[2] were little used and remained as had been envisaged by the drafters, a minor element in world trade relations.[3] Article XXIV is an exception from the Most-Favoured Nation principle[4] as set forth in Article 1 of the GATT according to which "... any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties".[5] The MFN exception for RTAs is codified in the chapeau of paragraph 5 of article XXIV which states that: "the provisions of this agreement...shall not prevent the formation of a customs union or free trade area...".[6] Article XXIV has attracted much controversy and heightened speculation concerning the exact meaning of its provisions, application and extent of coverage.[7]



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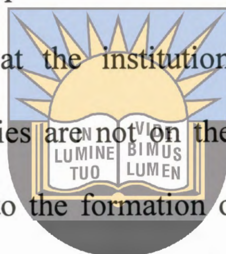
[1] Hereinafter the GATT.
[2] Hereinafter RTAs.
[3] This however changed in 1957 with the notification to the GATT of the Treaty of Rome creating the European Economic Community (EEC). The birth of the EEC, an event of prime political and economic importance required the GATT contracting parties to interpret certain provisions of Article XXIV for the first time. See the WTO Secretariat *Regionalism and the World Trading System* (1995) 11.
[4] Hereinafter MFN.
[5] Article 1 of the GATT. Subedi argues that if the current trend of bilateral, regional or preferential trade agreements continue to accelerate not only the MFN principle will be undermined but the future of the WTO as well. See Subedi "The Notion of Free Trade and the First Ten Years of the World Trade Organization: How Level is the Level Playing Field?" 2006 *Netherlands International Law Review* 273 291.
[6] Article XXIV: 5 of the GATT.
[7] For instance, the Treaty of Rome was drafted with GATT rules in mind but the examination of the Treaty revealed diametrically opposed views among different parties on the compatibility of several of its provisions with Article XXIV. See the WTO Secretariat *Regionalism and the World Trading System* (1995) 11. Many attribute the inability of the GATT to deal with RTAs to past structural inadequacies of the GATT. See Bagwell and Staiger *The Economics of the World Trading System* (2002) 26.

The key substantive provisions of Article XXIV are Article XXIV: 4, XXIV: 5 (a), (b) and (c), Article XXIV: 6 and XXIV: 8 (a) (i) (ii) and (b).

- Article XXIV: 4 declares a general principle that the purpose of a customs union (CU) or of a free trade area (FTA) should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.
- Article XXIV: 5 sets out the conditions under which CUs and FTAs can be formed. Article XXIV: 5(a) provides that a CU can be formed if the duties or other regulations imposed at the institution of such a CU with regard to commerce with outside parties are not on the whole higher or more restrictive than those applicable prior to the formation of such a CU. Article XXIV: 5(b) provides the same conditions with regard to a FTA.
- Article XXIV: 6 states that, if a member of a CU or a FTA increases tariffs above the concession rate as a result of forming such a CU or FTA, it must enter into negotiations with non-members of the CU or FTA in terms of Article XXVIII of the GATT.
- Article XXIV: 8 defines CUs and FTAs. Article XXIV: 8 (a) (i) states that a CU is an entity in which duties and other restrictions of commerce are eliminated on substantially all the trade between the members of the union except those restrictions permitted under Articles XI, XII, XIII, XIV, XV and XX. Article XXIV: 8 (a) (ii) states that a CU establishes common tariffs and other restrictions of commerce with respect to commerce with members that are outside parties to the union. Article XXIV: 8(b) provides the same requirements with respect to a



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FTA except for the fact that there is no requirement of a common external tariff which applies to a CU.[8]

The operative requirements for a CU and a FTA to be compliant with the GATT are contained in two paragraphs, namely paragraphs 5 and 8.[9] Paragraph 8 describes the characteristics of CUs and FTAs and stipulates the initial conditions to be met in order to qualify for MFN deviation. This paragraph is commonly called the internal requirements paragraph. The external requirements in paragraph 5 are the second set of conditions to be met for CUs, FTAs or interim agreements to qualify for MFN deviation. CUs and FTAs are essentially different entities but the majority of the requirements laid down for RTA qualification are similar for both.

The main requirements which apply to both FTAs and CUs are:

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- Paragraph 8(a)(i) CUs and paragraph 8(b) FTAs - the internal requirements: Elimination of duties and other restrictive regulations of commerce with respect to substantially all the trade between the constituent territories; and,
- Paragraph 5(a) CUs and paragraph 5(b) FTAs - the external requirements: Not to raise duties or render other regulations of commerce more restrictive than prior to the formation of the CU/FTA.

The GATT refers to only two forms of regional integration schemes: free trade areas and customs unions. In principle, GATT law does not recognise any other forms of regional integration schemes. It however mentions "interim agreements" which one can describe as

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[8] The major difference between a FTA and a CU is that the latter requires a common external trade policy. Hoekman and Leidy argue that the existence of this common external trade policy may imply an upward bias in so far as it facilitates capture of instruments of contingent protection by anti-trade lobbies which leads to less competitive domestic markets due to more protection over time against outsiders. See Hoekman and Leidy "Holes and Loopholes in Integration Agreements: History and Prospects" in Anderson and Blackhurst (eds) *Regional Integration and the World Trading System* (1993) 239.

[9] See *Turkey-Textiles, Appellate Body Report, WT/DS34/AB/R* para 57 for the division of the paragraphs in Article XXIV into operative and purposive paragraphs.

agreements which do not yet fulfil all the requisites for a fully-fledged FTA or CU but which should, in the end, lead to such a RTA. It seems the underlying rationale for this inclusion is that it is hardly possible for a regional trade endeavour to become fully operative from scratch.[10] But why does the GATT not permit other forms of RTAs? The most probable answer is that it should be borne in mind that article XXIV was drafted in the immediate aftermath of World War II when forms of greater integration were not foreseeable or at least were not a real challenge to the multilateral trading system.[11]

The specification of these conditions to be met by RTAs has led to endless arguments between GATT and subsequently WTO members over whether particular agreements for the establishment of FTAs or CUs do or do not comply with the provisions of article XXIV or whether article XXIV in itself does or does not present a tool that threatens to dismantle the core values of the GATT albeit it being exceptionary in nature.[12] According to Dunkel, the

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> "exceptions and ambiguities which have thus been permitted have seriously weakened trade rules and make it very difficult to solve disputes to which article XXIV is relevant. They have set a dangerous precedent for further special deals, fragmentation of the trading system and damage to the trade interests of non-participants".[13]

And as Cho put it, "the apparently draconian GATT Article XXIV has proven to be a paper tiger".[14] In this sense, it is submitted that since the world trading order values multilateralism and can not at the same time deny the benefits of regionalism in spite of the negative connotations, a deliberate and concerted effort should be made to set out what the rules of regionalism and multilateralism mean in a manner that will be beneficial to world trade. The success of this effort is ultimately dependent on the commitment of all trading nations.

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[10] Hilpold "Regional Integration According to Article XXIV of the GATT: Between Law and Politics" in Bogdandy and Wolfrum (eds) 2003 *Max Planck Yearbook of United Nations Law* 219 226.
[11] *Ibid.*
[12] *Ibid.*
[13] Dunkel "Trade policies for a better future: The Leutwiler report, the GATT and the Uruguay Round". Available at http://www.worldcat.org/isbn/0898389259 (accessed 25/08/08).

[14] Cho "Defragmenting World Trade' 2006 *Northwestern Journal of International Law and Business* 39 54.

4.2 Purpose of Article XXIV

When analyzing legal texts, it is crucial to comprehend the context and purpose for which they were intended.[15] When analyzing multilateral law like the GATT, it becomes even more important because of the fact that such law is constituted between a large number of independent actors all of whom have a right to interpose a veto or at least abandon talks.[16] In order to understand the direction of GATT law on RTAs it is appropriate to consider the context in which the right to form regional arrangements was addressed in the charter of the International Trade Organization (ITO) and GATT negotiations as well as the states' intentions.[17] Therefore, the provisions of the GATT on RTAs must be viewed as a political compromise: exceptions for CUs and FTAs were part of the "embedded liberal" compromise to reconcile American multilateral principles with Britain's and Europe's need for domestic stability.[18] The relationship of WTO law and RTAs primarily depends on specific treaty language. Therefore answers need to be sought and developed largely within WTO law. The definition of an appropriate relationship is however supported by recourse to the relevant provisions of general treaty law because they inform treaty interpretation and are applicable in the absence of specific WTO rules addressing the relationship with RTAs.[19] They should be taken into account to the extent that they form part of customary international law, in

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[15] It has been argued that much of the existing literature on RTAs has been written by economists and as a result fails to provide legal analysis anchored on the purpose and objective of the multilateral trading system. See Cho 1996 *Northwestern Journal of International Law and Business* 44.

[16] Ethier asserts that while it can not be argued that multilateral trade liberalization is an important economic policy accomplishment, "actual multilateral trade agreements do not prevent countries from trying to influence their terms of trade". See Ethier "Political Externalities, Non-Discrimination and the Multilateral World". Available at http"//pier.econ.upenn.edu/Archive/02-030.pdf (accessed 20/10/08).

[17] Marceau *Anti-dumping and Anti-trust Issues in Free Trade Areas* (1994) 178.

[18] Ruggie *International Regimes, Transactions and Change: Embedded Liberalism in the Post-war Economic Order* (1982) 392. However, this is not to say that all RTAs have their origin in political considerations. Many RTAs emphasize close historic, economic, geographical and cultural ties. See examples in Roesller "The Relationship between Regional Integration and the Multilateral Trade Order" in Anderson and Blackhurst (eds) *Regional Integration and the Global Trading System* (1993) 312.

[19] Cottier "The Legal Framework for Customs Unions and Free Trade Areas in WTO Law: Multilateralism and Bilateralism". Available at http://www.acp_eu_trade.org (accessed 20/08/09).

conformity with the rules of interpretation set forth in Article 3.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes.[20]

All interpretations of GATT rules shall according to the Dispute Settlement Understanding[21] be:

> "...in accordance with customary rules of interpretation of public international law".[22]

The general rules of treaty interpretation are codified in Articles 31 and 32 of the Vienna Convention on the Law of Treaties[23] and are as follows:

Article 31(1) reads:

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".[24]

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This has been confirmed by the WTO's Appellate Body on several occasions. For instance, in *United States-Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea (US- Line Pipe)*,[25] it was stated that "We are, as always, guided by Article 31(1) of the Vienna Convention, which codifies the fundamental rule of treaty interpretation...".[26]

Article 32 provides for supplementary means of interpretation and states that:

> "Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
>
> (a) Leaves the meaning ambiguous or obscure; or

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[20] *Ibid.*
[21] Hereinafter the DSU.
[22] Article 3.2 of the DSU.
[23] Hereinafter the VCLT.
[24] Article 31(1) of the VCLT.
[25] WT/DS202/AB/R 15 February 2002.
[26] *US-Line Pipe* para 244. See also *United States- Standards and Conventional Gasoline (US-Gasoline)* WT/DS2/AB/R 20 May 1996 16-17.

(b) Leads to a result which is manifestly absurd or unreasonable.[27]

Consequently, the purpose and context, as well as the ordinary meaning of the text shall act as guides when interpreting Article XXIV of the GATT. It has been said that the purpose of treaty interpretation under articles 31 and 32 is to ascertain the common intention of the parties.[28] In the *United States- Measures Affecting the Cross-border Supply of Gambling and Betting Services* (*US-Gambling*) case[29] the panel held that such common intention can exist even if one of the parties involved is known not to have had that intention.[30] However, this view appears to contradict the Appellate Body's earlier ruling that the common intention cannot be ascertained on the basis of subjective and unilaterally determined expectations of one of the parties.[31] As regards Article 31(1), it seems it was a routine step for panels and was a frequent one for the appellate body to determine the ordinary meaning of the rules of the GATT by quoting from dictionary definitions.[32] The implicit justification for this process seemed to be that an ordinary meaning must be one that occurs in at least one such definition. In some instances, all the elements of the definition were quoted and occasionally it appeared as if the panel regarded the term as meaning all those elements at the same time.[33] However, the Appellate Body has warned against excessive reliance on dictionaries in deriving the ordinary meaning of treaty provisions.[34]

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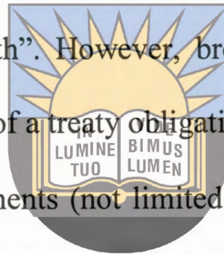
[27] Article 32 of the VCLT.
[28] MacGovern *International Trade Regulation* (2008) 2173. See also *United States- Measures Affecting the Cross-border Supply of Gambling and Betting Services* (*US- Gambling*) WT/DS285/AB/R 7 April 2005 para 159.
[29] WT/DS285/AB/R.
[30] *US-Gambling* para 6.136.
[31] *European Communities-Customs Classification of Certain Computer Equipment (EC-Computer Equipment)* WT/DS62/7/8/AB/R 5 June 1998.
[32] MacGovern 2173.
[33] *Ibid.*
[34] *US Gambling* para 164.

Furthermore, WTO dispute settlement bodies have made the following observations about paragraph 1 of Article 31[35]:

- The "good faith" requirement in Art 31(1) suggests "... that a promise to have recourse to and abide by the rules and procedures of the DSU, also in one's legislation, includes the understanding to refrain from adopting national laws which threaten prohibited conduct".[36] This was said in the context of the use of threats to coerce other states. Article 26 of the VCLT entrenches the principle of *pacta sunt servanda:* "every treaty in force is binding upon the parties to it and must be performed by them in good faith". However, breach of good faith does not flow automatically from the violation of a treaty obligation.[37]
- The texts of international agreements (not limited to those of which WTO members are parties) and other international texts may be explored in order to elucidate the ordinary meaning,[38] but the WTO is not bound by definitions adopted by other organizations.[39]
- Paragraph 1 of Article 31 does not require a panel to ignore the ordinary meaning of a term simply to accommodate a conflicting contextual interpretation.[40]
- The object and purpose is that of the treaty in its entirety, but account can be taken of the object and purpose of particular treaty terms.[41]



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[35] MacGovern 2173.
[36] *United States-Section 301-310 of the Trade Act of 1974* (*US-Section 301 Trade Act*) WT/DS152/R 22 December 1999 para 7.68.
[37] *United States-Continued Dumping and Subsidy Offset Act of 2000* (*US-Offset Act- Byrd Amendment*) WT/DS217/AB/R 16 January 2003 para 298.
[38] *European Communities-Measures Affecting Approval and Marketing of Biotech Products* WT/DS291/2/3/R 10 October 2006 para 7.92.
[39] *Ibid.*
[40] *Canada-Measures affecting Export of Civilian Aircraft* (*Canada-Aircraft*) WT/DS70/R 14 April 1999 para 9.118.
[41] *European Communities-Customs Classification of Frozen Boneless Chicken Cuts* (*EC-Chicken Cuts*) WT/DS286/AB/R 12 September 2005 para 238.

- The degree to which a provision's context is relevant and the weight to be given to its contextual element will differ from case to case and may depend, *inter alia*, on the relationship between the provision being interpreted and the provision relied upon as context.[42]

The object and purpose of GATT article XXIV is stated in paragraph 4 of the Article as well as in the Understanding on the Interpretation of Article XXIV of the GATT:

> "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".[43]

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This statement on the one hand expresses the positive approach of the GATT towards the existence and proliferation of RTAs and on the other hand expresses the two-edged character of RTAs by emphasizing the purpose such agreements should have in order to fit with the multilateral trading system.[44] Since it can not be denied that RTAs will continue to be an important feature of the world trading system, it is submitted that the above statement is a sound assessment of the analysis of paragraph 4 in the sense that it paves the way for RTAs to co-exist with if not reinforce the multilateral trade system.[45]

Paragraph 4 is supported by the statement in the preamble of the Understanding on the Interpretation of Article XXIV of the GATT that:

> "Members,

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[42] *United States-Tax Treatment for "Foreign Sales Corporations"* (*US-FSC)* WT/DS108/R 8 October 1999 para 7.90.

[43] Article XXIV: 4 of the GATT.

[44] Herrmann "Bilateral and Regional Trade Agreements as a Challenge to the Multilateral Trading System" *EUI Working Paper* (2008/09) 6.

[45] According to Roessler, there is no RTA with the exception of the European Communities that covers all subject matters resulting from the Uruguay Round. Under these circumstances it no longer seems justifiable to conceive all RTAs as legal instruments designed to replace the GATT system in relations between the member countries. Given the legal complexities that arise from the co-existence of RTAs and the GATT legal system it seems more necessary to expressly regulate RTAs in their relation with the GATT system. See Roessler 319.

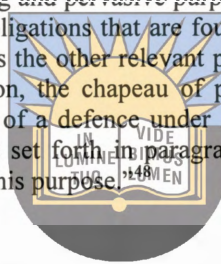
Having regard to the provisions of Article XXIV of GATT 1994;
Recognizing that customs unions and free trade areas have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade;

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".[46]

Furthermore, in *Turkey-Restrictions on Imports of Textiles and Clothing Products* (*Turkey-Textiles*)[47] the Appellate body held that:

> "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."[48]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Accordingly, the provisions of Article XXIV shall be interpreted with the above statements in mind, and in compliance with the VCLT. This means that for a group of countries to enjoy the benefits of the MFN exception stipulated in Article XXIV, they must show creation and growth of world trade as opposed to protectionism, discrimination, diversion and decrease of international trade.[49]

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[46] Preamble of the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994.
[47] WT/DS34/AB/R.
[48] WT/DS34/AB/R para 57.
[49] Lockhart and Mitchell "Regional Trade Agreements under GATT1994: An exception and limits" in Mitchell (ed) *Challenges and Prospects for the WTO* (2005) 219.

4.3 Analysis of Article XXIV

Article XXIV of the GATT specifies the conditions under which countries can deviate from the MFN obligation by forming RTAs.[50] It imposes four principal conditions on RTAs namely, that RTAs:

- Must not, "on the whole" raise protection against excluded countries;
- Must reduce internal tariffs to zero and remove "other restrictive regulations of commerce" except those justified by other GATT articles;
- Must cover "substantially all trade" between the members; and
- Must be notified to the WTO.[51]

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The GATT's logic is essentially mercantilist, stressing the rights of trading partners to market access, rather than economic, which would focus on the economic costs and benefits of policy.[52] Similarly, the GATT could also be useful in creating a "level playing field" to ensure that nations compete on an equal footing.[53] Bhagirath Das submits that the GATT should be viewed as an instrument of international cooperation by which one benefits from the well being of one's neighbours and not from appropriating their rightful possessions.[54] From a mercantilist point of view, the first two conditions make sense:

[50] Marceau argues that the right to form discriminatory regional groupings was customary in international law and that the GATT law and practice have not seriously changed this essential right of states to ally for security and trade purposes. According to him Article XXIV should therefore be viewed as containing guidelines rather than conditions for the realization of trade creative free trade areas and invites all member states to phase out all regulations restricting trade between them. See Marceau 167.

[51] Article XXIV of the GATT.

[52] Frankel, Stein and Wei "Introduction to Regional Trading Agreements". Available at http://ctrc.sice.oas.org/TRC/Articles/Regionalism/sw_ch8.pdf (accessed 14/04/08).

[53] Subedi "The Notion of Free Trade and the First Ten Years of the World Trade Organization: How Level is the Level Playing Field?" 2006 *Netherlands International Law Review* 273 275.

[54] Das *The WTO and the Multilateral Trading System: Past, Present and Future* (2003) xii. Likewise, Hoekman and Mavroidis argue that the GATT must be regarded as a mechanism for exchanging trade policy instruments and agreeing on a code of conduct. See Hoekman and Mavroidis *The World Trading Organization: Law, Economics and Politics* (2007)15.

- The first preserves the sanctity of tariff bindings by ensuring that forming a RTA does not provide a wholesale means of dissolving previous bindings.[55]
- The second condition helps to defend the MFN clause by making it subject to an "all-or-nothing" exception. If countries were free to negotiate different levels of preference with each trading partner, tariff bindings and the non-discrimination principle would be fatally undermined.[56]
- The third condition reinforces this by requiring a serious degree of commitment to an RTA in terms of sectoral coverage.[57]

GATT Article XXIV requirements are clearly intended to minimize the negative trade diverting effects of RTAs.[58] It is submitted that when these conditions are rigidly enforced the efficacy of Article XXIV could be improved. Article XXIV also makes sense when viewed as a guide to economic policy.[59] The requirement not to raise the average level of protection against excluded countries' exports not only honours the latter's market access rights, but also removes one otherwise available route to increased protectionism.[60] Article XXIV could therefore be generally regarded as an aid to the establishment better RTAs. However, there are major difficulties in interpreting the WTO conditions on regionalism.

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[55] This is supplemented by the requirement that compensation is due to individual partners for tariff increases induced by the RTA if other reductions to keep the average constant do not maintain a fair balance of concessions. Together with the provisions of the 1994 Uruguay Round Understanding on the Interpretation of Article XXIV on how to measure tariff barriers for RTAs, these provisions offer reasonable assurances about the barriers facing non-members. See Frankel, Stein and Wei "Introduction to Regional Trading Agreements". Available at http://ctrc.sice.oas.org/TRC/Articles/Regionalism/sw_ch8.pdf (accessed 14/04/08).

[56] No member could be sure that it woulld receive the benefits it expected from negotiating and reciprocating for a partner's tariff reduction. Also, if a customs union is a first step toward nation building, it is inappropriate that an international trade treaty should stand in the way of such progress. Thus, internal free trade, such as one usually achieved within a single country, would seem to be an acceptable derogation from MFN, whereas preferences would not be. See Frankel, Stein and Wei "Introduction to Regional Trading Agreements". Available at http://ctrc.sice.oas.org/TRC/Articles/Regionalism/sw_ch8.pdf (accessed 14/04/08).

[57] *Ibid.*

[58] Bagwell and Staiger *The Economics of the World Trading System* (2002) 27.

[59] Snape argues that the economics of Article XXIV is best looked at in terms of the process of developing a liberalizing trading system rather than in terms of the resource allocation implications of particular RTAs considered on their own. See Snape "History and Economics of GATT's Article XXIV" in Anderson and Blackhurst (eds) Regional *Integration and The Multilateral Trade Order* 1993 (287).

[60] *Ibid.*

In paragraph 8, the internal requirements for RTAs to enjoy the benefit of MFN deviation are laid down. The paragraph is divided into two sub-sections (a) and (b) where CUs are treated under paragraph 8(a) (i) and (ii) and FTAs under paragraph 8(b). The main difference between CUs and FTAs is found in paragraph 8(a) (ii) which requires a CU to establish a common external trade regime as well as a common internal trade regime. The provisions of paragraphs 8(a) (i) (CU) and 8(b) (FTA) regarding the requirement to eliminate duties and other restrictive regulations of commerce are similar in wording, with the only difference being that a CU in paragraph 8(a) (i) should eliminate duties and other restrictive regulations of commerce on substantially all the trade between the constituent territories of the union. FTAs, however, are only required to fulfil the latter, i.e. eliminate duties and other restrictive regulations of commerce on trade in products originating from any of the constituent territories of the FTA. These different wordings together constitute the main differences in requirements between FTAs and CUs under paragraph 8. FTAs are not required to establish a common external trade regime; as a consequence, they do not have to establish a common internal market.

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4.3.1 Analysis of the Internal Requirements: Article XXIV: 8

Summarily, Article *XXIV: 8* of the GATT 1994 provides that:

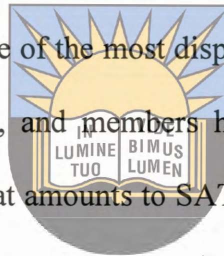
- Members of a customs union eliminate duties and other restrictive regulations of commerce with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories (except where necessary, those permitted under Articles XI, XII, XIII, XIV and XX);[61]
- substantially the same duties and other regulations of commerce be applied by each of the members of the union to the trade of territories not included in the union;[62] and
- Members of a free-trade area are required to eliminate duties and other restrictive regulations of commerce on substantially all the trade between the constituent territories in products originating in such territories.[63]

[61] Article XXIV: 8 (a) (i) of the GATT.
[62] Article XXIV: 8 (a) (ii) of the GATT.
[63] Article XXIV: 8(b) of the GATT.

The phrases that have been subject to much contention regarding the internal requirements to be fulfilled by a customs union or a free trade area have been identified for purposes of this study as follows: the requirement for coverage of "substantially all trade", "other regulations of commerce", "other restrictive regulations of commerce" and the bracketed list of exceptions.

4.3.1.1 The requirement for Coverage of Substantially all trade (SAT)

The phrase "substantially all trade" as it appears in paragraph 8, which defines the meaning of the terms CUs and FTAs, has been one of the most disputed provisions of article XXIV. It has been faulted for not defining SAT, and members have been unable to agree on the proportion of the actual trade covered that amounts to SAT, whether it involves the inclusion of all major sectors of the economy or not or how 'all the trade' within a RTA is to be measured.[64]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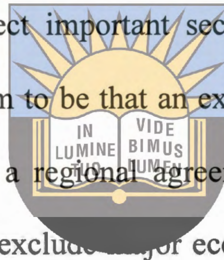
The two main competing approaches to the interpretation of SAT that have been put forward by GATT and WTO members over the years are as follows;

- A quantitative approach, which involves using some kind of statistical benchmark, such as a certain percentage of trade between the parties to indicate that the coverage of a given RTA fulfils the requirement.[65] A key objection to this approach is that it would not preclude the exclusion of entire sectors in cases where trade in that sector had hitherto been prevented by prohibitive trade barriers.[66]

[64] Scollay "Substantially all Trade: Which definitions are fulfilled in Practice? An Empirical Investigation" *A Report to the Commonwealth Secretariat* (2005) 3.
[65] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 15/08/08). Percentages commonly suggested in this context are 90%, 85%, and 80%.
[66] Scollay 3.

- A qualitative approach, according to which the SAT requirement means that no sector (or at least no major sector) is to be kept out of intra-RTA trade liberalization. This approach aims at preventing the exclusion from RTAs liberalization of any sector where the restrictive policies in place before the formation of the RTA hindered trade.[67] However, it seems probable that the difficulty in the definition of "sector" might also be a subject of debate. It might also be questioned whether the inclusion of a very minor component of a major sector could be deemed to satisfy this definition.[68] The qualitative approach is designed to prevent RTA parties from maintaining restrictions to protect important sectors from competition within the RTA.[69] The rationale would seem to be that an exception to WTO rules should only be granted when the parties to a regional agreement have shown commitment to closer integration. If the parties exclude major economic sectors from liberalization, that commitment is deemed to be lacking.[70]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In the area of goods, it still is controversial whether comprehensiveness amounts to a qualitative or a quantitative approach, or a combination of both.[71] Most RTAs, in particular, those in Europe (including Switzerland) exclude preferential trade in agriculture or address it only in part.[72] Parties to such agreements argue that entire goods sectors can be excluded from preferential agreements provided that the agreement covers the lion's share of total

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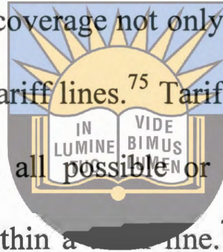
[67] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 15/08/08).
[68] *Ibid.*
[69] Mitchell and Lockhart 233.
[70] *Ibid.*
[71] Cottier "The Legal Framework for FTAs and CUs in the WTO Law". Available at http://www.acp_eu_trade.og (accessed 20/08/08).
[72] *Ibid.* The same views are also expressed by Hoekman and Leidy. According to them, "holes" in RTAs are quite similar to those in the GATT. For example, the agricultural sector is normally excluded from liberalization while the textile, clothing and steel sectors tend to be given "special" treatment. The agricultural and textiles sectors are often regarded as the major areas where the GATT has failed to induce governments to abide by multilateral rules but RTAs illustrate that these sectors either tend to be excluded in regional agreements as well or are subject to collective intervention. See Hoekman and Leidy 236.

trade.[73] An agreement covering only trade in industrial goods would fulfil that requirement as only up to twenty per cent of trade might be excluded. There is no agreement on this point, and it cannot be said that the exclusion of agriculture qualifies as subsequent treaty practice or even customary law due to the persistent objection by agro-exporting countries.[74]

Three further approaches to the definition of SAT have been suggested as possible ways to clear up the ambiguity: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- Characterizing a RTA's product coverage not only in terms of trade flows but also in terms of a certain percentage of tariff lines.[75] Tariff lines can be used as a criterion to ensure that liberalization covers all possible or potential trade between the RTA parties because all goods fall within a [illegible] line.[76] However, using tariff lines may give a misleading impression of the extent to which trade has been liberalized, for instance, where actual trade flows between the RTA partners are concentrated in a few tariff lines.[77] If restrictions on these few tariff lines were maintained, a large share of current trade could escape liberalization. Conversely, a large number of tariff lines may be devoted to a small amount of actual trade, for example, a large number of the

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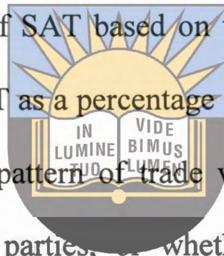
[73] *Ibid.*
[74] Third countries have questioned whether the agreements that explicitly excluded trade in unprocessed agricultural products as is the case in most agreements meet the requirement of SAT. The exclusion of agricultural products is generally due to the restrictive trade policy regimes most governments maintain in this sector as part of domestic programs to support farmers' income and although this exclusion is typical in free trade areas, it is more exceptional for customs unions. For example, the signatories of Sweden's free trade area with the Baltic States in defending their agreement maintained that the criterion of Article XXIV on the SAT requirement be based on substantially all trade between the parties and not on trade in substantially all products or sectors. Thus what these parties believed was that the language of the SAT requirement did not prevent the exclusion of a sector of economic activity such as agriculture provided that their overall trade was substantially covered. The counter argument in this case was that the observed value of trade in a given sector may be low as a result of impediments to trade and not because of its having an intrinsically lesser economic or trade importance. See the WTO Secretariat *Regionalism and the World Trading System* (1995) 13.
[75] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 15/05/08).
[76] Scollay 7.
[77] Mitchell and Lockhart 233.

Harmonized Commodity Description and Coding System (HS) tariff lines deal with agricultural products which may account for only a small portion of actual trade.[78]

- As a refinement to the quantitative approach, calculating the percentage of trade between the parties under the RTA rules of origin.[79]

- A definition stating that all sectors should be included.[80]

A further issue relevant to definitions of SAT based on the percentage of trade covered is whether it is appropriate to calculate SAT as a percentage of the trade existing at the time the agreement enters into force, when the pattern of trade will be influenced by the existing pattern of trade barriers between the parties, or whether it should be calculated as a percentage of the trade that would exist once the barriers are removed.[81] In a sense this question is of largely academic interest, because it is unlikely that WTO members would ever agree on a basis for estimating the amount of trade that would occur in the absence of restrictions.[82]



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4.3.1.1.1 SAT as an Economic Issue

The economic rationale for the SAT requirement is not altogether clear. Laird notes that exclusion of products in which at least one of the parties is internationally competitive will indeed reduce the scope for trade creation, thus limiting the potential welfare gains from the

[78] Scollay 8.
[79] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 15/05/08).
[80] *Ibid.*
[81] *Ibid.*
[82] *Ibid.*

agreement.[83] On the other hand, exclusion of products in which both parties are internationally uncompetitive will limit the potential for trade diversion, and could therefore be welfare enhancing. It is not difficult however to conceive of situations where inclusion of "sensitive products" could be trade diverting even if one party is an internationally competitive producer. If the protected market is shared between several internationally competitive suppliers, the supplier that secures preferential access through a RTA may be able to displace the other competitive suppliers from the market, to their obvious detriment.[84] Even if the preferred partner is unable to supply the entire market, the result may be some trade diversion combined with a welfare loss for the importing partner that is not offset by the gain to the exporting partner.[85] Frankel has suggested a model in which the optimal result is obtained by partial liberalisation within successively larger preferential groupings, until free trade is attained at the final stage of expansion when all countries become members of the group.[86] Less optimistic arguments are put forward by scholars, such as Andriamananjara, who highlight the ways in which preferential liberalisation may create disincentives for multilateral liberalisation.[87] Another concern is that the greater the ease with which "sensitive" sectors can be excluded from RTAs, the more countries with a considerable number of "sensitive" sectors that they wish to protect may be attracted to preferential liberalisation rather than multilateral liberalisation.[88] This line of argument suggests that a loose interpretation of SAT could be very damaging for the multilateral trading system.[89]

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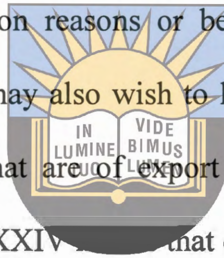
[83] Laird "Regional Trade Agreements: Dangerous Liaisons". Available at www./atn.org.ar/achieves/documentacion/PAPER-Doc01%20.op_Laird_Regional%20trade%20agreement.pdf (accessed 12/09/08).
[84] Scollay 9.
[85] *Ibid.*
[86] Frankel "Regional Trading Blocs in the World Economic System". Available at http://www.petersoninstitute.org/publications/chapterpreview/72/1iie2024.pdf (accessed 28/04/08).
[87] Andriamananjara "On the Size and Number of Regional Trading Agreements: A Political Model". Available at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/1999 (accessed 20/10/08).
[88] *Ibid.*
[89] Roessler argues that proposals to judge RTAs in the light of economic efficiency considerations cannot be easily transformed into a rule of conduct capable of influencing the behaviour of governments negotiating a

4.3.1.1.2 SAT as a Negotiating Issue

Regardless of the economics of SAT, the issue of how SAT should be interpreted has become increasingly important to developing countries as more and more of them enter into negotiations for RTAs with developed country partners. In some cases these negotiations are their first encounter with SAT and other requirements of GATT Article XXIV, since earlier agreements with developing country partners have been notified under the 1979 Enabling Clause.[90] The extent of product coverage will often be a negotiating issue in these "North-South" RTAs. Developing countries will often wish to exclude some traded items from these agreements, either for revenue protection reasons or because of sensitivities attached to particular industries or sectors.[91] They may also wish to limit the scope for their developed country partners to exclude products that are of export interest to themselves.[92] Lack of clarity over the interpretation of Article XXIV means that developing countries lack certainty as to the conditions that should be satisfied in order to fulfil the SAT requirement, and therefore as to what negotiating positions can reasonably and legitimately be adopted on this issue.[93] This lends credence to the suggestion that in the context of negotiating RTAs, industry lobbies that block genuine multilateral liberalization are more frequently able to control regional liberalization initiatives as well.[94]



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4.3.1.1.3 SAT as a political issue

An important rationale of the "SAT" requirement is that it helps countries resist the inevitable pressures to avoid or minimize tariff reductions in efficient import competing sectors.[95] The

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regional agreement. Further that whether a regional agreement covers substantially all trade can be determined by the governments when they negotiate it. See Roessler 313.

[90] Scollay 9.

[91] *Ibid.*

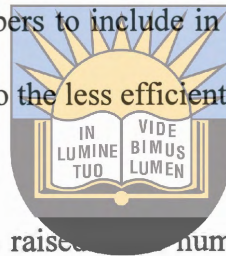
[92] *Ibid.*

[93] *Ibid.*

[94] Hoekman and Leidy 236.

[95] The WTO Secretariat *Regionalism and World Trade* (1995) 9

requirement also ensures that regional agreements are limited to those which have sufficient political support in member countries to overcome the protectionist opposition to more or less complete free trade among the participants and that agreements are not used as a cover for narrow discriminatory arrangements.[96] This will help differentiate between politically unavoidable and containable deviations from the MFN principle by determining the point where trade policy is allowed to give way to foreign policy.[97] However, Roessler has argued that the standard conclusion that tariff preferences may or may not increase welfare depending on whether they divert trade or create trade "makes little sense" on the SAT requirement because it will oblige members to include in their RTAs preferences that divert trade from the more efficient producers to the less efficient producers.[98]



The question of what SAT meant was raised on a number of occasions even before the coming into being of the WTO in 1995. It was raised once in connection with the European Free Trade Association (EFTA) when the Treaty of Stockholm exempted agriculture from its liberalization regime.[99] In the GATT Working Party, there was a view that "substantially all trade" should be interpreted to have not only quantitative but also qualitative features.[100] This view maintained that even if the rate of liberalization of internal trade reached 90% quantitatively, this should not lead to the automatic approval of the FTA.[101] The representatives of the EFTA maintained that Article XXIV allowed some restrictions with regard to products by providing for "substantially all trade" instead of "substantially all

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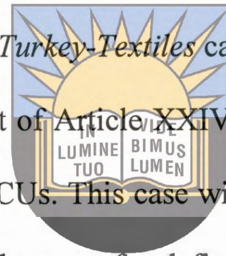
[96] *Ibid.*
[97] *Ibid.*
[98] Furthermore, Roessler argues that the SAT requirement should be used to serve a useful domestic policy function as a means of containing the "moral hazard" that could result from domestic protectionist pressures. Roessler 314.
[99] Matsushita "Legal Aspects of Free Trade Agreements in the context of Article XXIV of the GATT 1994". Available at www.worldtradelaw.net.pdf (accessed 19/05/08).
[100] *Ibid.*
[101] *Ibid.*

products". Although no consensus was reached in this Working Party, the prevailing view was that at least both qualitative and quantitative tests should be used.[102]

Another GATT Working Party which examined the EEC-Finland Free Trade Agreement in 1973 took the view that the "substantially all trade" test should be interpreted to require liberalization of all products; it should not be interpreted to allow the exemption of a particular sector of the economy in its entirety.[103] In this view, to exempt entire sectors of the economy from liberalization would be contrary to Article XXIV no matter what the quantitative coverage of this sector may be in total trade.[104] The SAT issue has been considered by the Appellate Body in the *Turkey-Textiles* case.[105] It was held that the meaning of "substantially all trade" in the context of Article XXIV: 8 (a) appears to contain both the qualitative and quantitative elements of CUs. This case will be dealt with in detail in chapter 5. It is therefore submitted that in the absence of a definitive ruling on this point, the SAT requirement should be regarded as containing both qualitative and quantitative elements.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4.3.1.2 Meaning of the terms "Other Regulations of Commerce" (ORC) and "Other Restrictive Regulations of Commerce" (ORRC)

The conception of the term ORC is of interest due to its similarity to the term ORRC. The term ORC can be found in paragraph 8(a) (ii) and ORRC in paragraph 8(a) (i) both targeting CUs and further in paragraph 8(b) which targets FTAs. The GATT neither defines nor specifically distinguishes these terms. ORRC is used to deal with intra-RTA regulation while

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[102] *Ibid.*
[103] Analytical Index of the GATT: Guide to WTO Law and Practice *BISD 21S/79*. Available at http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_09_e.htm (accessed 12/07/08).
[104] *Ibid.*
[105] WT/DS34/AB/R.

ORC is used to deal with barriers to external trade.[106] In the terms of Article XXIV: 4, ORRC deals with "facilitating" intra-RTA trade, while ORC deals with avoiding raising barriers to external trade. However, in substantive terms, both refer to barriers to trade.[107] According to Islam and Alam it appears that the rationale behind the removal of other regulations of commerce according to the GATT drafters was that if the requirement was strictly followed it would in all likelihood restrict trade diversions and an influx of RTAs.[108]

Paragraph 8(a) (ii) can generally be interpreted as requiring a CU to establish a common external trade regime. In fact, the establishment of a common external trade regime is impossible without the simultaneous establishment of a common internal trade regime; therefore, negatively interpreted, paragraph 8(a) (ii) also requires the abolition of internal trade barriers.[109] The same requirement can be found in paragraph 8(a) (i) regarding CUs. However, there is a difference: in paragraph 8(a) (i), the elimination of ORRCs is required but in paragraph 8(a) (ii) the elimination of ORCs is prescribed.[110]

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In paragraph 8(a) (ii) the expression "ORC" is completely detached from the "restrictive" requisite, since it is not at all found in the paragraph. Considering that paragraph 8(a) (ii) only targets CUs, it can, on good grounds be assumed that the provision is supposed to mean something different from the ORRC concept in provisions targeting both FTAs and CUs.[111] Therefore on a textual basis, the absence of 'restrictive' in the paragraph can be assumed to

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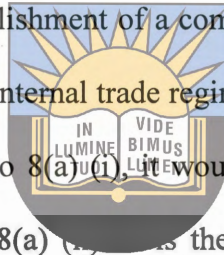
[106] Trachtman "Towards Open Regionalism? Standardization and Regional Integration under Article XXIV". Available at http://www.wto.org/english/tratop_e/region_e/sem_april02_e/joel_trachtman (accessed 19/03/09).
[107] *Ibid.*
[108] Islam and Alam "Preferential Trade Agreements and the Scope of GATT Article XXIV, GATS Article V and the Enabling Clause: An Appraisal of GATT/WTO Jurisprudence" 2009 *Netherlands International Law Review* 1 14.
[109] *Ibid.*
[110] *Ibid.*
[111] Laird and Crawford "Regional Trade Agreements and the WTO". Available at http://www.nottnghamuniversity.com/economics/credit/research/papers/cp.003.pdf (accessed 02/09/08).

indicate that the phrase ORC in paragraph 8(a) (ii) is meant to distinguish itself from the similar ORRC concept found in paragraph 8(a) (i) and 8(b).[112] This then suggests that ORC in the context of 8(a) (ii) has a wider scope than ORRC, since the word "restrictive" qualifies the expression "other restrictive regulations of commerce". If ORC has a broader scope than ORRC, it is fair to assume that ORC encompasses regulations other than border measures, e.g. internal measures such as technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures and/or measures covered by GATT Article III (national treatment).[113] This is a logical conclusion, considering the common interpretation of paragraph 8(a) (ii) as requiring the establishment of a common external trade regime, which in consequence also requires a common internal trade regime.[114] Since substantially all duties and ORRC must be removed pursuant to 8(a) (i), it would be redundant to merely require their removal once again in paragraph 8(a) (ii). It is therefore a qualified suggestion that paragraph 8(a) (ii) requires the elimination of measures internally, i.e. harmonization of internal trade regulations, in addition to elimination of duties and ORRC pursuant to 8(a) (i).[115]



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The ORRC term was contributed by the United States as part of the original customs union paragraph in the Suggested Charter for the International Trade Organization prepared for the London preparatory conference (1946).[116] The term remained intact through the New York drafting session, the Geneva preparatory conference and the Havana Conference. At least for the existing conference and committee documents, there is no record of a delegate ever

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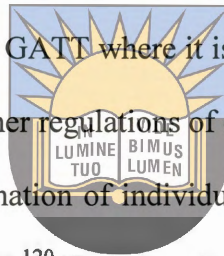
[112] *Ibid.*
[113] Dynefors-Hallberg *A Legal and Political View on Regional Trade Agreements in the GATT/WTO* (LLM thesis, Gothenburg University, 2007) 54.
[114] *Ibid.*
[115] Trachtman "Towards Open Regionalism? Standardization and Regional Integration under Article XXIV". Available at http://www.wto.org/english/tratop_e/region_e/sem_april02_e/joel_trachtman (accessed 19/03/09).
[116] Mathis "Regional Trade Agreements and Domestic Regulation: What reach for Other Restrictive Regulations of Commerce?" Available at www.hss.ed.ac.uk/ila/docs/session2Mathis.rtf (accessed 23/10/08).

seeking any clarification regarding the meaning of ORRC or challenging the terminology in any respect.[117] For the GATT working group review practice, ORRC discussions have centred on importation and exportation questions and only rarely considering domestic or regulatory aspects.[118] The main question that has been raised for ORRC since at least the EEC Overseas Association review (1958) has been whether or not the Articles′ listing is exhaustive or only indicative, and therefore whether it does or does not include an obligation for the members to eliminate safeguard and anti-dumping measures in a finalised RTA.[119]

Certainly, the difficulty in interpreting these provisions is recognized in the Understanding on the Interpretation of Article XXIV of the GATT where it is stated 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".[120] Therefore it is submitted that what is needed in the meantime is for members to consider the provisions of Article XXIV in their overall purpose rather than to try to work out or piece together what they think each separate wording of the provision means.



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4.3.1.3 ORRC and the bracketed List of Exceptions in Article XXIV

Incorporated between duties/ORRC and SAT is the bracketed list of exceptions which apply to both the ORRCs and the duties in paragraph 8(a) (ii) and 8(b):

> "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"[121]

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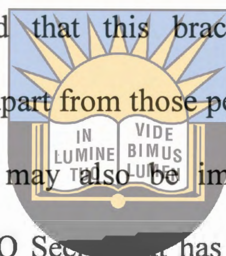
[117] *Ibid.*
[118] *Ibid.*
[119] *Ibid.*
[120] Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994 para 2 Available at www.wto.org See also Laird and Crawford "Regional Trade Agreements and the WTO". Available at http://www.nottnghamuniversity.com/economics/credit/research/papers/cp.003.pdf (accessed 02/09/08).
[121] Article XXIV: 8 of the GATT.

From the ordinary meaning of the words and expressions, and their placement in the paragraph, it seems reasonable to infer that the articles listed in the bracketed list of exceptions are *de facto* ORRCs and/or duties.[122] This is due to the use of the word "except" which insinuates that the trade measures/barriers contemplated by articles XI-XV and XX are duties and/or ORRCs yet exempted from the requirement of elimination.[123] Consequently, the articles in the bracketed list of exceptions are ORRCs, duties or a combination of duties and ORRCs which may be retained in respect of SAT between the members.[124]

Some WTO members have suggested that this bracketed list of measures is only illustrative.[125] In other words, measures apart from those permitted under Articles XI-XV and XX, such as trade remedy measures, may also be implicitly included in the list and maintained within the RTA.[126] The WTO Secretariat has observed that the drafting history does not indicate why Articles XI-XV and XX were included in the list of exceptions while others, in particular Article XIX were excluded.[127] The Appellate Body however stated in the *Turkey Textiles* case that the bracketed words allow parties to maintain measures otherwise permitted under Articles XI-XV and XX.[128] While not a definitive ruling on this issue, the WTO Secretariat has noted that this statement suggests that the Appellate Body would read the bracketed list as containing an exclusive list of ORRCs that may be maintained by the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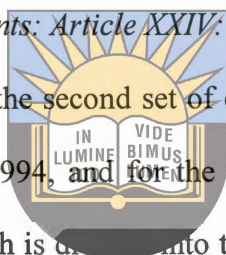
[122] Dynefors-Hallberg *A Legal and Political View on Regional Trade Agreements in the GATT/WTO* (LLM thesis, Gotheburg University, 2007) 45.
[123] *Ibid.*
[124] *Ibid.*
[125] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 15/05/08).
[126] *Ibid.* Islam and Alam also argue that a narrow scope of the listed articles in the exception does signify that the list is not exhaustive. For example, it would be unthinkable that all trade restrictions imposed on the basis of national security exceptions under Article XXI must be eliminated between RTA parties. Furthermore, it seems implausible to argue that by reaching an agreement to establish a RTA, the parties would pledge their security would never be threatened by the actions of their partners. See Islam and Alam 2009 *Netherlands International Law Review* 15.
[127] The WTO Secretariat "Systemic Issues Related to Other Regulations of Commerce" WT/REG/W/17/Rev.1 5 February 1998 para 6.
[128] *Turkey-Textiles* para 48.

RTA.[129] The Secretariat has noted further that the Appellate Body also recognizes that the general requirement of elimination of ORRC offers some flexibility to the parties to a customs union (and presumably also to a FTA) to maintain certain types of ORRC.[130] However, it cautioned that this flexibility is limited by the requirement that ORRC be eliminated with respect to substantially all internal trade.[131] In addition, Mitchell and Lockhart opine that the exception should be regarded as applicable only where necessary although the text provides no guidance as to when it is necessary to maintain restrictions.[132]

4.3.2 Analysis of the External Requirements: Article XXIV: 5

As explained earlier, paragraph 5 holds the second set of conditions to be met for a RTA to be formed in compliance with GATT 1994, and for the parties to such RTA to enjoy the benefit of MFN exception. The paragraph is divided into two sub-sections (a and b) just like paragraph 8, where the provisions for CUs (a) and FTAs (b) are elaborated separately.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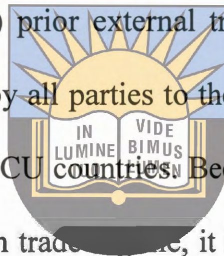
However, the chapeau of paragraph 5 holds operative language by stating the important MFN exception. Since the concepts of ORC and ORRC have been dealt with extensively under Article XXIV: 8, they will be covered only briefly in the foregoing discussion of Article XXIV: 5. Particularly important to the interpretation of the concept of ORC is the issue of Rules of Origin. The crux of the analysis of the external conditions as provided for in Article XXIV: 5 will rest however on the requirement not to raise trade barriers externally by the imposition of higher duties or more restrictive regulations than existed prior to the formation of the RTA. This requirement calls for a comparison between the average incidence of duties and ORC prior to and after the formation of a RTA in order to establish whether those (duties

[129] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 15/05/08).
[130] *Turkey-Textiles* para 48.
[131] *Ibid.*
[132] Mitchell and Lockhart 240.

and ORC) have become higher or more restrictive as a consequence of the RTA formation.[133] Therefore, paragraph 5 can be regarded as a prohibitory provision against the use of RTAs as an excuse for raising duties and ORCs. The requirements applying to CUs and FTAs are divided into two sub-sections of paragraph 5, where 5(a) deals with CUs and 5(b) with FTAs.

4.3.2.1 Article XXIV: 5(a) - Customs Unions

The formation of a CU is distinguished from the FTA provisions by the requirement in paragraph 8(a) (ii) to apply a common external trade regime to third countries. This means that each country's (customs territory's) prior external trade regime is substituted for one common external trade regime, applied by all parties to the CU to the extra-regional trade of the CU, i.e. imports to the CU from non-CU countries. Because of the substitution of several individual trade regimes for one common trade regime, it is difficult to compare the level of duties and ORCs applied prior to the formation of a CU to the corresponding level of duties and ORCs after the formation.[134] For this reason paragraph 5 calls for a comparative assessment of the general incidence of duties and ORCs applicable in each customs territory prior to the formation, with the general incidence of duties and ORCs in the commonly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[133] MacMllian criticizes this rule on the ground that it focuses on the wrong variable. He argues that tariffs do not directly affect people's wellbeing but affect it indirectly through their impact on trade volumes and thereby on people's consumption. The volume of trade more directly affects welfare and so its makes more sense to look at the RTA's effects on trade volumes. Further that even if tariffs were held at their average pre-RTA level, integration could result in considerable trade diversion. See McMillan "Does Regional Integration Foster Open Trade? Economic Theory and GATT Article XXIV" in Anderson and Blackhurst (eds) *Regional Integration and the Global Trading System* (1993) 7.

[134] In the examination of the Treaty of Rome, third countries argued that members of a CU or a FTA should not raise barriers to the trade of any individual third country while the EEC was of the view that such an interpretation would be inconsistent with the requirement that duties and other regulations imposed at the institution of the union should not on the whole be higher or more restrictive than the general incidence prior to the formation of the union. The requirement had been interpreted by the EEC to apply to third countries as a group rather than individually and to not preclude the raising of barriers to trade in a sector or sub-sector of merchandise trade provided barriers were lowered in other sectors or subsectors. See the WTO Secretariat *Regionalism and the World Trading System* (1995) 13.

applied trade regime after the formation.[135] The assessment is explained in further detail in the Understanding on the Interpretation of Article XXIV:

> "The evaluation…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 the import statistics for a previous representative period to be supplied by the customs unions, on a tariff-line basis and in values and quantities, broken down by WTO country of origin… duties and charges to be taken into consideration shall be the applied rates of duty".[136]

This provision provides a structure for the quantification of duties and charges, which are easily quantifiable. Furthermore it clarifies that it is the applied rates of duty that should be taken into consideration.[137] Still, it falls short of providing a practical structure for the quantification and aggregation of other regulations of commerce, when it merely states that it is a difficult task:

> "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."[138]

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The problem of non-tariff barriers to trade such as ORC has been recognized earlier, hence in the Agreement on agriculture, a method for "tariffication" of non-tariff barriers was implemented.[139] The purpose of "tariffication" was to substitute non-tariff barriers for tariff barriers for the purpose of making them quantifiable so that they would be easier to calculate. However, the method has been criticized by some contracting parties for actually raising barriers to trade instead of dismantling them.[140]

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[135] *Ibid.* What is clear here is that the provision is not referring to the average tariffs of each individual product but the whole level of tariffs in a customs union. See Das B *The World Trade Organization: A Guide to the Framework for International Trade* (1999) 25.
[136] Understanding on the Interpretation of Article XXIV of the GATT para 2.
[137] Dynefors-Hallberg *A Legal and Political View on Regional Trade Agreements in the GATT/WTO* (LLM thesis, Gotheburg University, 2007) 75.
[138] Understanding on the Interpretation of Article XXIV para 2.
[139] Agreement on Agriculture available at http://www.wto.org/engling/doc_e/legal_e/legal_ehtm#a
[140] Lockhart and Mitchell 250.

4.3.2.2Article XXIV: 5(b) - Free Trade Areas

Like Article XXIV: 5(a), sub-paragraph 5(b) calls for a comparison between two sets of ORC: those "existing" prior to the formation of the FTA, and those "applicable" at the formation of the FTA. For customs unions, we saw that the comparison under Article XXIV: 5(a) is between the "general incidence" of all ORCs applied before and after the formation of the union. For FTAs, Article XXIV: 5(b) calls for a comparison between the ORCs applied after the formation of the FTA and the "corresponding" ORCs applied before formation. The use of the word "corresponding" suggests that specific ORCs should be compared as they applied before and after the formation of the FTA.[141] This view is consistent with the nature of economic integration through FTAs. As with parties to customs unions, FTA parties must eliminate most "duties and other restrictive regulations of commerce" on substantially all internal trade. However, as stated above, FTA parties have no obligation to adopt common rules for external trade, and parties to an FTA typically continue to impose their own external trade regimes. Therefore, Article XXIV: 5(b) prevents an FTA party from using the formation of an FTA as an opportunity to increase the burden of any individual ORC it imposes on external trade.[142] In Article XXIV, such an increase is essentially deemed unnecessary to the formation of an FTA and is inconsistent with the purpose of Article XXIV to minimise the restrictive effects of RTAs on external trade.[143]

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4.3.2.3 Article XXIV: 6 - Compensation for non-members

The formation of a CU may require increases of some bound rates of duty, because of the substitution of trade regimes. Since paragraph 5(a) calls for duties to not on the whole,become higher as a result of the CU formation, some duties may be raised and some

[141] Trachtman "Towards Open Regionalism? Standardization and Regional Integration under Article XXIV". Available at http://www.wto.org/english/tratop_e/region_e/sem_april02_e/joel_trachtman (accessed 19/03/09).
[142]Lockhart and Mitchell 251.
[143]*Ibid*

lowered as long as the general incidence of duties has not become higher than prior to the CU formation.[144] Paragraph 6 merely establishes a compensatory procedure in a case where non-CU members are affected by the imminent increase of a certain duty as a result of the CU formation.[145] On the contrary the existence of paragraph 6 regarding CUs, indicates that a FTA formation is not entitled to a corresponding increase of duties.[146]

4.3.2.4 Rules of Origin

The requirement not to raise trade barriers externally by the imposition of higher duties or more restrictive regulations than prior to the formation of the RTA may create a difficult problem for the interpretation of ORC with regard to Rules of Origin (RoOs).[147] RoOs are defined as those laws, regulations and administrative determinations of general application applied by any Member to determine the country of origin of goods.[148] One of the questions in this regard is whether or not rules of origin are "other regulations of commerce". Although there is a view that rules of origin should be regarded as restrictions of trade, there is also strong opposition to that view.[149] The WTO Negotiating Group on Rules of Origin has presented three distinct interpretations of RoOs and ORCs that;

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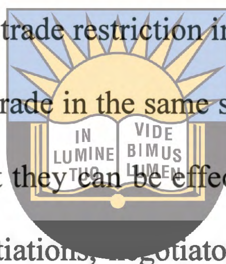
- RTA origin rules constitute an ORC;
- RTA origin rules do not constitute an ORC, given that by definition they do not affect trade with third parties; and

[144] *Ibid*
[145] *Ibid.*
[146] *Ibid.*
[147] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 15/05/08).
[148] Agreement on Rules of Origin available at http://www.wto.org/english/docs_e/legal_/22-roo.pdf (accessed 25/04/08).
[149] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 15/05/08).

- A case-by-case examination of the preferential rules of origin in RTAs is needed. That examination would clearly indicate whether these rules had restrictive effects on trade *vis-a-vis* third parties.[150]

In the GATT Working Party which examined the compatibility of the North American Free Trade Agreement (NAFTA) with GATT rules, the United States of America argued that RoOs are not trade restrictions in the same sense as tariffs and quantitative restrictions.[151] In this view, rules of origin are a test by which to determine which product benefits from the preferential treatment of a FTA but not a trade restriction in itself.[152] It is submitted that while RoOs can not be regarded as barriers to trade in the same sense as tariffs and quotas, they are currently an important trade issue in that they can be effectively used as some form of trade restriction. In the Uruguay Round negotiations, negotiators tackled the issue of whether or not rules of origin were "other restrictions".[153] However, they were unable to reach any agreement as to whether they were or were not "other restrictions".[154] The only consensus reached was to state that there be transparency in the enforcement of rules of origin in FTAs.[155]



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If rules of origin are ORC there is still a problem.[156] Article XXIV: 5 (a) requires that tariffs and other trade restrictions after the formation of the FTA shall not be higher or restrictive than those before its formation. The question is "what is before?"[157] If an existing FTA is enlarged to create another FTA, for example, the transformation of the Canada-United States

[150] *Ibid.*
[151] *Ibid.*
[152] *Ibid.*
[153] The WTO Secretariat "Systemic Issues Relating to Other Regulations of Commerce" WT/REG/W17 31 October 1997.
[154] *Ibid.*
[155] *Ibid.*
[156] Matsushita "Legal Aspects of Free Trade Agreements in the context of Article XXIV of the GATT 1994". Available at www.worldtradelaw.net.pdf (accessed 19/05/08).
[157] *Ibid.*

Free Trade Agreement (CUSFTA) into the North American Free Trade Agreement (NAFTA), the answer may lie in a comparison between the common rules of origin existing at the time of the Canada-United States Free Trade Agreement and those of the NAFTA.[158] However, what if a new FTA is entered into? There would be no pre-existing common rules of origin. Those rules of origin were created only after the formation of the FTA.[159] Then the question is what rules should be compared with what rules. Should the common rules of origin be compared with those of each Member before the formation of the FTA? However, a Member may have applied a "tariff classification rule" while others may have applied "the substantial transformation rule".[160] This would make it very difficult to compare situations before and after the FTA formation. No panel or Appellate Body reports have clarified this issue. Therefore, it remains unresolved.

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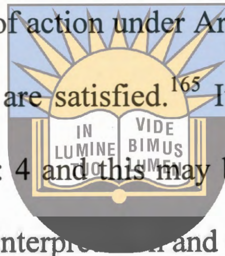
4.3.2.5 The Relationship between Article XXIV: 4 and XXIV: 5-9

Article XXIV: 4 announces the general principles and XXIV: 5-9 set out the specific requirements. A recurrent general question has been whether paragraph 4 of Article XXIV contains requirements additional to those specified in paragraphs 5-9 or whether it should merely be viewed as introducing the latter provisions.[161] What then is the relationship between these provisions? In particular, are the requirements of Article XXIV: 4 satisfied as long as the requirements provided for in Article XXIV: 5-9 are fulfilled. If the answer is yes, then all that is required is to fulfil the requirements of Article XXIV: 5-9 and XXIV: 4 will not create an independent cause of action.[162] If the answer is no, there can be a cause of action even if all the requirements in Article XXIV: 5-9 are satisfied. The European Union

[158] *Ibid.*
[159] *Ibid.*
[160] The WTO Secretariat "Systemic Issues Relating to Other Regulations of Commerce" WT/REG/W17 31 October 1997.
[161] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/W/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 26/05/08).
[162] *Ibid.*

has contended that as long as the requirements provided for in Article XXIV: 5-9 are satisfied, the requirement of XXIV: 4 does not create any independent cause of action.[163] In particular, the European Union has maintained that where a new restriction is created by the formation of a CU in respect of each independent measure, there is no increase of trade barriers in relation to outside countries as prohibited in Article XXIV: 4 as long as there is no increase in the level of protection as provided for in XXIV: 5(a).[164] Others, however, maintain that if a particular new trade measure is applied as a result of the formation of a CU, that new measure constitutes an increase of trade barriers prohibited by Article XXIV: 5 and, therefore, there is an independent cause of action under Article XXIV:4 regardless of whether the requirements of Article XXIV: 5-9 are satisfied.[165] It is to be noted, however, that the word "should" is used in Article XXIV: 4 and this may be an indication that the paragraph "provides only for general principles of interpretation and is hortatory in nature".[166]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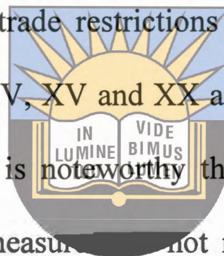
4.3.2.6 The relationship between Article XXIV and other WTO agreements: The Case of Trade Remedies

Whether or not WTO trade remedies can be applied within a RTA is an important question. It is not only important as a matter of legal interpretation of Article XXIV but also as a matter of internal politics when negotiating a RTA.[167] In many countries, there are sensitive sectors of the economy in which interest groups react strongly to the proposal to conclude a RTA as

[163] "General Agreement on Tariffs and Trade Analytical Index" Spec (85)60 18 December 1985 available at www.wto.org (accessed 20/04/09).
[164] Matsushita "Legal Aspects of Free Trade Agreements in the context of Article XXIV of the GATT 1994". Available at www.worldtradelaw.net.pdf (accessed 19/05/08).
[165] *Ibid.*
[166] *Ibid.* In this respect, the Appellate Body Report in the *Turkey-Textiles* case stated at paragraph 57 that paragraph 4 contains purposive and not operative language, that 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 the Article.
[167] The WTO Secretariat "Synopsis of Systemic Issues Related to Regional Trade Agreements" WT/REG/W/37 2 March 2000.

exemplified by the agricultural groups in Japan.[168] This proves that whenever a negotiation for a RTA is initiated, the negotiators should be able to present some proposals to domestic interest groups detailing the available remedies for injury that may be caused to sectors of the economy.[169] The question raised here is whether trade remedy measures such as antidumping duties, safeguard measures etc are a solution. This is primarily an issue of examining whether or not Article XXIV allows an interpretation that trade remedies can be applied to imports originating within the regional grouping.[170]

Article XXIV:8 states that tariffs and trade restrictions must be liberalized but measures adopted under Articles XI, XII, XIII, XIV, XV and XX are exempted from the obligation to liberalize and can be maintained.[171] It is noteworthy that Article XIX of the GATT and antidumping and countervailing duty measures are not mentioned. Therefore, an apposite interpretation is that the obligation to liberalize applies to the trade remedy measures and there is obligation under Article XXIV: 8 for a member of a CU or FTA to refrain from applying a safeguard, antidumping or countervailing measure.[172] On this interpretation, a member of a CU or FTA which is also a member of the WTO can apply safeguard or antidumping measures to imports coming from other WTO members who are not members of the CU or the FTA.[173] The rationale for this interpretation is that the premise of trade remedy measures is that trade is already liberalized; accordingly there is no need for trade remedy measures.[174] Trade remedy measures apply once trade is open. In this view, trade remedy measures apply within the FTA since the essence of a FTA is to liberalize trade. On this



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[168] *Ibid.*
[169] *Ibid.*
[170] *Ibid.*
[171] Article XXIV: 8 of the GATT.
[172] Matsushita "Legal Aspects of Free Trade Agreements in the context of Article XXIV of the GATT 1994". Available at www.worldtradelaw.net.pdf (accessed 19/05/08). See further Islam and Alam 2009 *Netherlands International Law Review* 15.
[173] *Ibid.*
[174] *Ibid*

interpretation, it is a mistake to over emphasize the wording of Article XXIV: 8 and deny the possibility of applying trade remedy measures within a FTA.[175]

However, if the economic integration within a customs union has progressed to the extent that industries in the participants have become a "community industry" (such as in the European Union), there is no domestic industry in a participating country which needs to be protected from imports, dumping and subsidization by another participating country.[176] The question of what types of trade remedy measures should be instituted was debated when negotiations took place between Singapore and Japan with a view to concluding an EPA/FTA agreement.[177] With regard to antidumping and countervailing duty measures, four views were presented with regard to this issue:

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- One was that there should be no trade remedy measure applicable between the two countries.

[175] See Pauwelyn's study on how WTO members that are also part of a RTA should conduct safeguard investigations and apply eventual safeguards in line with WTO rules. She examines the question whether the WTO can exclude regional imports from injury determinations, whether they must apply the eventual safeguard only to third parties or whether they are under an obligation to apply all safeguards in a non-discriminatory basis. She makes the following conclusion:

- That based on the requirements of Article XIX,WTO members who are also part of a RTA must exclude imports from within the region as a basis for WTO safeguards if such imports are also covered by the preferential trade deal;
- That in contrast, the Agreement on Safeguards is silent on the source of imports that must be taken into account in a safeguard injury determination. All imports can be considered but one can also exclude regional imports or only take account of imports from one source;
- That in principle, the eventual safeguard measure itself must be applied to all imports on a non-discriminatory basis subject to Article XXIV;
- That the requirement of parallelism, that is, equivalence between the imports considered in the injury determination and those made subject to the safeguard measure is an unnecessary complication to deal with a problem better solved under Article XXIV itself or Article 2.2 of the Agreement on Safeguards in combination with Article XXIV; and
- That Article XXIV does not *per se* prohibit safeguards on trade within a RTA and can be used as a justification not only for violations of Article XIX but also of the Agreement on Safeguards. See Pauwelyn "The Puzzle of WTO Safeguards and Regional Trade Agreements" 2004 *Journal of International Economic Law* 109 140.

[176] *Ibid.*

[177] Matsushita "Legal Aspects of Free Trade Agreements in the context of Article XXIV of the GATT 1994". Available at www.worldtradelaw.net.pdf (accessed 19/05/08).

- The second was that there should be no trade remedial measure provided that a sufficient degree of harmonization of competition laws is achieved. This view advocates that trade remedy rules be supplanted by the law of predatory pricing.[178]
- The third was that there should be stricter disciplines on trade remedy measures between the two countries with regard to antidumping and countervailing duties than the WTO disciplines require such as a higher *de minimus* rule.
- The fourth is that antidumping and countervailing duty measures can be applied between the two countries on the basis of WTO disciplines.[179]

The negotiators decided to adopt the fourth approach and incorporated the rule that antidumping and countervailing duty measures apply in accordance with WTO rules.[180] Other approaches would be effective only if there was a closer economic integration between the participating countries as exemplified by the European Union and the Closer Economic Relations Agreement between Australia and New Zealand.[181] In respect of safeguard measures, the negotiators decided to include a provision for regular safeguard measures under the requirements of Article XIX of the GATT 1994 and the Safeguards Agreement.[182]

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Another problem is whether a customs union or a FTA is allowed automatically to extend the coverage of an outstanding safeguard or antidumping/countervailing measure with regard to a new entrant into the customs union or the FTA.[183] For example, suppose the European Union has applied an antidumping measure to products from Japan and when a new member joins the European Union, the question arises as to whether the European Union can extend the protection of this antidumping measure to this new member by imposing antidumping duties

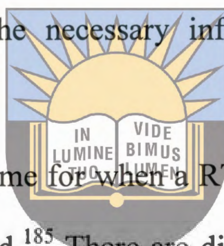
[178] *Ibid.*
[179] *Ibid.*
[180] *Ibid.*
[181] *Ibid.*
[182] *Ibid.*
[183] Laird and Crawford "Regional Trade Agreements and the WTO". Available at http://www.nottnghamuniversity.com/economics/credit/research/papers/cp.003.pdf (accessed 02/09/08).

on products imported to the territory of this Member from Japan. If this were allowed, would it not mean that an antidumping duty is imposed on products from Japan imported into the territory of this new member without investigation?[184]

4.3.3 Analysis of the Procedural Requirements: Article XXIV: 7

Article XXIV: 7 provides for two procedural requirements to be met by RTAs:

- Firstly, members are required to promptly notify other contracting parties of the agreements they conclude or decide to enter into; and
- Secondly, they must provide the necessary information regarding the proposed agreements.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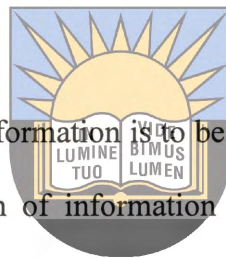
According to this provision, the time frame for when a RTA should be notified by members is not precisely formulated nor expressed.[185] There are different possibilities with respect to the point in time when notification of a RTA should occur; whether at the conclusion of the RTA negotiation, when the agreement is signed, when it is ratified or when it enters into force.[186] The WTO Secretariat has observed that in practice RTAs are notified when their texts have already been sealed or even already in force.[187] As a result this has been found to restrain the effectiveness of the examination process.[188] In the past, it has been suggested that

[184] *Ibid.*
[185] Some members of the WTO specifically the European Communities have argued that the lack of precision in the text reflects the "pragmatism" necessary to address complex negotiations for the formation of a RTA, a particularly relevant matter in the case of large agreements in which the bulk of concessions are made at the last minute. Further that, if the relevant WTO rules were made too strict, their effectiveness and legitimacy would be called into question. See The WTO Secretariat "Synopsis of Systemic Issues Related to Regional Trade Agreement" WT/REG/W/37 2 March 2000 para 13.

[186] Sampson 23.
[187] The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/W/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 26/05/08).
[188] This has been found to be particularly true for interim agreements. The WTO Secretariat has noted that in the GATT/WTO history, most free trade areas and customs unions have been implemented in stages and very few have been notified as interim agreements. Consequently, the detailed provisions dealing with interim agreements as provided for by Article XXIV have become redundant. Unclear issues relating to the transition periods have however been highlighted in the examination of RTAs. These relate to:

- Whether RTA parties can apply a longer transition period (longer that the 10 years provided for by the GATT) to some products instead of excluding them from the scope of the agreement straightaway?

the words "shall promptly notify" and "decide to enter" should be interpreted to mean that the notification and submission of information should take place at least before the entry into force of the RTA.[189] However, taking into account the complexities of issues surrounding RTAs, and more specifically the political and legal difficulties related to notifying RTAs prior to their ratification, it has been suggested that a case-by-case approach is more appropriate in dealing with the problem created by the ambiguity of this provision.[190] Despite this flexibility allowed to members of the WTO in the timing of the notification of RTAs, a large number of RTAs still remain un-notified and this often hinders any comprehensive and precise evaluation of RTAs.[191]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Article XXIV does not stipulate what information is to be provided to the WTO by members of the RTA.[192] This issue of provision of information has been debated with Members' opinions differing with respect to both the quantitative and the qualitative nature of the statistics to be submitted by the parties.[193] Canada has argued that a maximum amount of statistical information is necessary not only to assess the conformity of RTAs with WTO rules but also to understand how the economies of parties to RTAs adjust to the evolution of trade patterns independently from any determination about the trade creation or diversion

- What would qualify as a "full explanation" by parties to an interim agreement with transitional periods longer than 10 years?
- When should interim agreements fulfill the requirements spelt out in paragraphs 5 and 8: at the time of entry into force of the interim agreement or when the RTA has been fully implemented?
- Whether consideration of the requirements to eliminate "other restrictive regulations of commerce" in paragraph 8 and "other regulations of commerce" in paragraph 5 of Article XXIV be different in fully implemented RTAs and Interim agreements? See The WTO Secretariat "Compendium of Issues Related to Regional Trade Agreements" TN/RL/W/8/Rev.1 1 August 2002. Available at www.wto.org (accessed 26/05/08).

[189] *Ibid.*

[190] *Ibid.* This undertaking was also recognized as a "very complex undertaking" in the *Turkey-Textiles* panel report WT/DS34/R para 9.52.

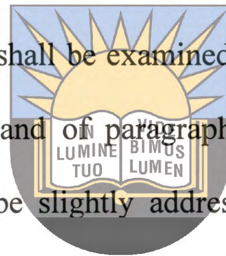
[191] The WTO Secretariat "Synopsis of Systemic Issues Related to Regional Trade Agreement" WT/REG/W/37 2 March 2000 para 15.

[192] However, it should be noted that non-binding guidelines in the form of a standard format are now provided by the Chairman of the Committee on Regional Trade Agreements. See "Standard Format for Information on Regional Trade Agreements" WT/REG/W/14 and "Notification Format for Regional Trade Agreements" WT/REG/16 23 November 2006. Available at http://www.wto.org/english/tratop_e/region_e/trans_mecha_e.htm.

[193] The WTO Secretariat "Synopsis of Systemic Issues Related to Regional Trade Agreement" WT/REG/W/37 2 March 2000 para 18.

effects of the RTA.[194] A counter argument has pointed out that not only are the detailed statistics requested often hard to obtain if not unavailable but also given the fact that the dynamics of RTAs are little understood such statistics may prove misleading.[195] During past individual RTA examinations the United States of America has requested parties to provide statistical information also on the trade they conducted under other RTAs.[196] However, the response especially from Norway has been that no legal obligation exists to supply information beyond the scope of a particular examination.[197]

According to the Understanding on the Interpretation of Article XXIV, 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 the GATT and of paragraph 1 of the Understanding.[198] It is submitted that these issues appear to be slightly addressed by the Understanding on the Interpretation of Article XXIV as it still does not offer an indication of what the word "promptly" implies or the type of information to be provided to the GATT. It is therefore submitted that since a time frame of "at least 90 days advance notice" has been suggested for the same requirement in the General Agreement on Trade in Services (GATS) Article V dealing with RTAs, the same can be called for in GATT Article XXIV: 7 (a).



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4.3.4 Understanding on the Interpretation of Article XXIV of the GATT 1994 [199]

As a result of the difficulties surrounding the interpretation of Article XXIV it was recognised by GATT members that the role of the Council for Trade in Goods in reviewing

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[194] Committee on Regional Trade Agreements "Note on the Meeting of 27 November and 4-5 December 1997" WT/REG/M/15 13 January 1998 para 26. Available at http://docsonline.wto.org/imrd/GEN_searchResult.asp (accessed 03/11/09).

[195] *Ibid.*

[196] See WTO doc US- WT/REG12/M/2 para 26 as cited in The WTO Secretariat "Synopsis of Systemic Issues Related to Regional Trade Agreement" WT/REG/W/37 2 March 2000.

[197] See WTO doc Norway- WT/REG12/M/2 para 30 as cited in The WTO Secretariat "Synopsis of Systemic Issues Related to Regional Trade Agreement" WT/REG/W/37 2 March 2000.

[198] Para 7 of the Interpretation on Article XXIV of the GATT.

[199] Hereinafter, The Understanding.

agreements notified under this provision needed to be enhanced.[200] This had to be pursued in part by clarifying the criteria and procedures for assessment of new and enlarged agreements and by so doing improve the transparency of all agreements notified.[201] To archive this end the Understanding on the Interpretation of Article XXIV was entrenched to provide for greater guidance on some issues. The Understanding provides that RTAs should facilitate trade between the constituent territories and not raise barriers to the trade of non-members; furthermore, they should to the greatest possible extent avoid creating adverse effects on the trade of other members.[202] While the Understanding has not changed the wording of Article XXIV nor has charted a new course for RTAs, it has attempted to clarify the meanings of some of the controversial concepts found in Article XXIV of the GATT. As a result, a number of issues have been addressed:

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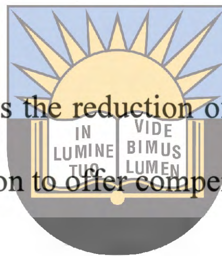
- The Understanding provides generally that in order to meet the requirements of Article XXIV, RTAs must comply with the provisions of paragraphs 5, 6, 7 and 8.[203]
- Further, the preamble of the Understanding provides that the contribution to the expansion of world trade would be increased if the elimination of duties and other restrictive regulations of commerce extend to "all trade" and would be diminished if "any major sector or trade is excluded". It is submitted that this interpretation could assist in defining what the substantially all trade requirement encompasses as it gives an indication of the proportion of actual trade to be covered and sectors to be included.
- 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

[200] Hoekman and Kostecki 354.
[201] *Ibid.*
[202] Preamble of the Understanding.
[203] The Understanding para 1.

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.

- The reasonable length of time referred to in paragraph 5(c) should exceed 10 years only in exceptional cases and in cases where members party 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.
- When a member of a CU raises tariffs above the concession rate as a result of joining the CU, that member must negotiate with the outside WTO members in accordance with Article XXIV: 6.
- An outside Member which enjoys the reduction of tariffs due to the joining of a CU by a member is under no obligation to offer compensation.[204]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According to Bagwell and Staiger, thus far the verdict regarding the efficacy of Article XXIV and the accompanying Understanding has not been encouraging as almost all of the RTAs notified have not met the legal requirements of Article XXIV.[205] Nonetheless, the Understanding has somewhat allowed for a more rigorous interpretation and application of Article XXIV.[206] For instance, a question of whether the compatibility of an agreement with Article XXIV could be raised in dispute settlement proceedings, particularly in cases where a working party[207] examination had been completed and no action had been taken by contracting parties was a very controversial issue in the early years of the GATT.[208] This question was discussed at some length in connection with the United States of America's

[204] The Understanding para 2-6.
[205] Bagwell and Staiger 26.
[206] Switky "The Importance of Trading Blocs: Theoretical Foundations" in Kerremans and Switky (eds) *The Political Importance of Regional Trading Blocs* (2000) 123.
[207] Note that prior to 1996 RTA compatibility with Article XXIV provisions was determined by GATT Working Parties, a position which has since changed since now this determination falls upon the Committee on Regional Trade Agreements.
[208] Jackson "World Trade and The Law of GATT" in Jackson, Davey and Sykes Jr. (eds) *Legal Problems of International Economic Relations: Cases, Materials and Texts* (2002) 455.

challenge to the European Union's trade arrangements with a number of Mediterranean countries in the early 1980s.[209] The Understanding has sought to resolve this issue by providing that the provisions of Article XXII and XXIII of the GATT as applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of the provisions of Article XXIV relating to the formation of FTAs or CUs.[210] To monitor the process of RTAs in operation, the Understanding directs the establishment of a Committee on Regional Trade Agreements to review RTAs to ensure their compliance with both the spirit and letter of Article XXIV.[211]

4.3.5 The Committee on Regional Trade Agreements

In February of 1996 the Committee on Regional Trade Agreements[212] was established by the WTO General Council to function as a single body with the main objective to examine RTA conformity under GATT Article XXIV. In addition, the CRTA also has a mission to facilitate a streamlined reporting process and to deal with the systemic issues regarding RTAs, such as legal analysis of relevant GATT provisions on RTAs.[213] In 2000, the WTO Secretariat offered a structured synopsis of issues that were identified by WTO delegates as having a systemic significance in the course of CRTA discussions.[214] Issues raised by delegations for further analysis included the question of the impact of overlapping RTA membership on trade and investment patterns both for the parties to RTAs and third parties, and possible changes

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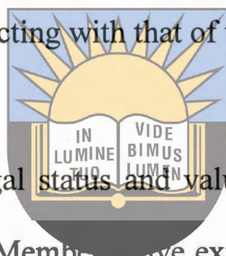
[209] *Ibid.*
[210] The Understanding para 12.
[211] Bhala and Kennedy *World Trade Law* (1998) 169.
[212] Hereinafter the CRTA. The CRTA's terms of reference (WTO doc WT/L/127) can be found at http://www.wto.org/english/tratop_e/region_e/127.pdf.

[213] Report of the Committee on Regional Trading Agreements *WT/REG/18* December 3 2007 para 4.
[214] The WTO Secretariat "Synopsis of Systemic Issues Related to Regional Trade Agreements" WT/REG/W/37 2 March 2000.

in WTO rights and obligations of members acceding to a CU.[215] Furthermore, the synopsis identified the following risks, *inter alia*, to the multilateral trading system:

- That, the MFN principle could be increasingly bypassed by the conclusion of agreements among RTAs;
- That the development of regional trade policy disciplines differing from those under the WTO agreements could lead to members abandoning some of their WTO rights when becoming parties to a RTA; and
- That dispute settlement provisions contained in new generation RTAs could build jurisprudence conflicting with that of the WTO.[216]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Delegates have thus argued that the legal status and value of RTAs remain unclear in the absence of conclusive reports.[217] Some Members have expressed the view that, even if clear conclusions are not spelled out, the mere fact of having concluded an examination and adopted a report that contains no recommendations to the parties to a RTA means that such RTAs are tolerated or deemed compatible by the WTO.[218] Even with the objectives of the CRTA clearly spelt out, it has not functioned properly. No examination by the body has been concluded due to the lack of consensus on how to interpret Article XXIV.[219] CRTA experience has underscored the fact that the two intertwined purposes of RTA examinations, that is, gathering information about a given RTA and judging whether the RTA complies with the relevant legal criteria constitute a problematic tandem.[220] For several reasons, in particular because of members' divergent understanding of the criteria contained in the rules

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[215] WT/REG/W/37 para 6.
[216] WT/REG/W/37 para 8.
[217] WT/REG/W/37 para 21.
[218] *Ibid.*
[219] Only one of the reports on the examination of RTAs adopted to date (the Czech Republic-Slovak Republic Customs Union) states clearly that the RTA is fully compatible with the relevant GATT rules. See the *World Trade Report 2007* 306 fn 304.
[220] The WTO Secretariat "Compendium of Issues related to Regional Trade Agreements" TN/RL/W/8/Rev.1 1 August 2002.

themselves, the examination mechanism has persistently failed to serve these purposes adequately. Lack of control is thus a threat to the proper functioning of such a vital exception as the one stated in Article XXIV.[221]

4.3.6 The Doha Ministerial Declaration of 2001

The multilateral trade system developed and continues to develop through a series of trade negotiations or rounds. The first rounds dealt primarily with reduction of tariffs and subsequently progressed to include other areas such the removal of non-tariff barriers. The Doha Development Agenda[222] is the latest in these rounds of multilateral trade negotiations. The DDA was launched in Doha, Qatar in November 2001 and provides the mandate for negotiations on a range of subjects.[223] With regards to RTAs, the declaration mandates negotiations aimed at "clarifying and improving disciplines and procedures under the existing WTO provisions applying to RTAs" and that these negotiations should take into account the developmental aspects of RTAs.[224] However, even after 8 years of its launch, the DDA is yet to be concluded.[225] The Director General of the WTO has opined that the "failure of the DDA would represent a lost opportunity to show that multilateralism works".[226] Presenting his

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[221] *Ibid.*

[222] Hereinafter the DDA.

[223] There are 21 subjects listed in the Doha Declaration. One of these concerns RTAs. The issue of RTAs is seen as a challenge especially now when nearly all member states are parties to regional agreements, are negotiating them or are considering negotiating them. These negotiations fell in the general timetable established for virtually all negotiations under the DDA and the original deadlines of 1 January 2005 were missed. See "Doha Development Agenda: The Doha Declaration explained". Available at http://www.wto.org/english/tratop_e/dda_e/dohaexplained_e.htm#regional (accessed 14/08/09).

[224] Para 29 of the Doha Ministerial Declaration of November 2001.

[225] Regarding rules aimed at clarifying the concept of RTAs negotiations, are stalled on three key issues:

- Methods to implement the concept of "substantially all trade";
- The length of transition periods;
- Inclusion of Special and Differential Treatment provisions in Article XXIV of GATT 1994. See Leo "The Doha Negotiations on Rules: An overview". Available at http://www.gmfus.org/doc/economics/The%20Doha%20Round%20Negotiations%20on%20Trade%Facilitation,%20An%20Overview%20-%20J%20Weekes%20and%20K%20Heerman.pdf (accessed 14/08/09).

[226] Report by the Director-General "Report to the Trade Policy Review Body on the Financial and Economic Crisis and Trade Related Developments" 26 March 2009. Available at www.wto.org (accessed 05/05/09).

second report on trade developments associated with the financial crisis at an informal meeting of the Trade Policy Review Body on 14 April 2009, Pascal Lamy stated that: "concluding the DDA is the surest way we have of safeguarding our individual trade interests and the multilateral trade system against the threat of an outbreak of protectionism".[227]

With regard to negotiations on procedural issues relating to RTAs, on 14 December 2006, the DDA provisionally adopted and approved a Transparency Mechanism (TM) for all RTAs.[228] The TM aims at making RTAs easier to examine for all contracting parties, mainly by requiring members to a RTA to make early announcement about entering into RTA formation or negotiations, and requiring RTA members to provide the WTO with the information needed for a proper examination.[229] It is yet to be seen whether the TM has made any difference to the CRTA's efficiency. However it is doubtful that transparency can remedy the crippled examination process since the main reason for its ineffectiveness has been interpretational issues and not whether RTAs have been notified or not.[230]

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4.4 Conclusion

A core objective of the multilateral trading system is the elimination of discriminatory treatment in international trade relations. In pursuit of this objective, WTO members must accord equal treatment to the goods and services originating from the territories of other

[227] Lamy "The Doha Development Round is the best stimulus package" WTO News Item 19 April 2009. Available at www.wto.org (accessed 27/04/09). A number of concerns on the deadlock of the DDA have also been raised. The EU Trade Commissioner Peter Mandelson warns that "it would be a terrible misjudgement if we let what we have now to slip away", adding that, "the alternative is not a better deal but no deal at all". Furthermore, he has expressed the view that the world would lose its "insurance policy" against the spread of protectionism and there will be a loss of confidence in the WTO system. See Mandelson "The alternative to what's on the table is not a perfect deal but no deal at all". Available at http://ec.europa.eu/commission_barosso/ashton/speeches_articles/sppm/38_en.htm (accessed 05/05/09).

[228] World Trade Organization "Transparency Mechanism for Regional Trade Agreements" Decision of 14 December 2006, WT/L/671. Available at http://www.wto.org/english/tratop_e/dda_e/dda_e.htm (accessed 05/05/09).

[229] *Ibid.*

[230] Dynefors-Hallberg *A Legal and Political View on Regional Trade Agreements in the GATT/WTO* (LLM thesis, Gotheburg University, 2007) 77.

WTO members.[231] In contrast, RTAs pursue trade liberalization through precisely this type of discrimination. The parties to a RTA liberalize trade solely amongst themselves, creating a network of special preferences within the RTA that are not available to other WTO members.[232] RTAs therefore entrench the very discrimination that the WTO rules seek to eliminate. The key difference in approach makes the relationship between multilateralism and regionalism both complicated and controversial. In economic terms, it is still not clear whether maintaining an ever growing network of RTAs alongside multilateral rules produces an overall increase or decrease in economic welfare.[233] In legal terms, the co-existence of the WTO and RTAs among WTO members creates a complex system of competing international rights and obligations.[234]

The WTO Agreements, including GATT 1994, are to be interpreted according to the words used in the treaty, read in their context, and in the light of the object and purpose of the treaty. Article XXIV: 4 sets out the purpose of the exception in Article XXIV: 5 of the GATT and therefore acts as a guide to understanding and applying that exception. This statement is complemented by the Understanding on the Interpretation of Article XXIV of the GATT 1994 in which WTO members expand further on the purpose of Article XXIV: 5. In the Understanding, WTO Members must:

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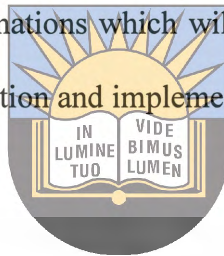
- recognise "the contribution to the expansion of world trade" that may be made through the establishment of CUs and FTAs;
- recognise that the expansion of world trade "is increased' if internal trade restrictions within an RTA are eliminated for 'all trade' and 'diminished if any major sector of trade is excluded"; and

[231] Mitchell and lockhart 1.
[232] *Ibid.*
[233] *Ibid.*
[234] *Ibid.*

• reiterate that the establishment of an RTA "should to the greatest extent possible avoid creating adverse effects on the trade of other Members".[235]

This chapter has explored some of the legal interpretation and enforcement questions surrounding Article XXIV, evaluating possible options while always keeping in mind the underlying purpose of the RTA exception. It has examined the views expressed by Members, as well as the text of the pertinent WTO agreements. Since the contentious issues relating to Article XXIV are largely interpretative, it is submitted that the WTO must attempt to develop or provide precise criteria for RTA formations which will in turn eliminate the ambiguities that have permeated the Article's application and implementation.



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[235] Preamble of the Understanding on the Interpretation of Article XXIV of the GATT.

CHAPTER 5

WTO JURISPRUDENCE

5.1 Introduction

The dispute settlement mechanism of the World Trade Organization[1] is a central element in providing security and predictability to the multilateral trading system.[2] Cho argues that the current proliferation of regional trade agreements has disrupted the original equilibrium between multilateralism and regionalism established under the General Agreement on Tariffs and Trade[3] in the 1940s and to remedy this crisis the equilibrium must be restored by defragmenting world trade through both institutional and judicial strategies.[4] While the GATT did not experience a lot of test of the compatibility of Regional Trade Agreements[5], the WTO dispute settlement system has been quite active since the founding of the WTO in 1995.[6] In view of WTO agreements, the importance of their impact, economic and otherwise, it is not surprising that WTO Members do not always agree on the correct interpretation and application of the rules governing these agreements.[7] Members frequently argue about whether or not a particular law or practice of a Member constitutes a violation of a right or obligation provided for in a WTO agreement.[8]

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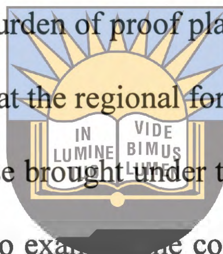
[1] Hereinafter the WTO.
[2] Jackson, Davey and Sykes Jr. *Legal Problems of International Economic Relations: Cases, Materials and Text* (2002) 254. There are four major phases of the WTO dispute settlement system/process. First, parties must attempt to resolve their differences through consultations. If that fails, the complaining parties can demand that a panel of independent experts be established to rule on the dispute. What would normally follow next would be a possibility of an appeal to the Appellate Body. Finally, if the complaining party succeeds, the Dispute Settlement Body is charged with the monitoring of the implementation of its recommendations. If the recommendations are not met, the possibility of negotiated compensation or authorization to withdraw one or more concessions arises. For further discussion see Palmeter and Mavroidis *Dispute Settlement in the World Trade Organization: Practice and Procedure* (1999).
[3] Hereinafter the GATT.
[4] Cho "Defragmenting World Trade" 2006 *Northwestern Journal of International Law and Business* 39 40.
[5] Hereinafter RTAs.
[6] Jackson, Davey and Sykes Jr. *Legal Problems of International Economic Relations* 269.
[7] Van den Boscche *The Law and Policy of the World Trade Organization: Text, Cases and Materials* (2005) 173.
[8] *Ibid.*

This part of the study will discuss the legal challenges that were made to certain aspects of regional trading agreements and subjected to dispute settlement procedures under the GATT and the WTO regimes. The discussion in this chapter will rest on two cases: *EEC - Member States' Import Regimes for Bananas*[9] and *Turkey-Restrictions on Imports of Textile and Clothing Products.*[10] However, a number of other cases would be briefly noted to illustrate how RTAs often adopt GATT inconsistent measures.[11] The *Bananas* 1 case though not officially reported is important as it continues to provide useful guidance in current disputes involving RTAs.[12] The impact of the *Bananas* 1 case flows from the view of Article XXIV of the GATT as a type of defence and the burden of proof placed upon the respondent party who has chosen to invoke it to demonstrate that the regional formation is an agreement sanctioned by the GATT.[13] The *Turkey-Textiles* case brought under the dispute settlement system of the WTO builds upon this unreported case to examine the compatibility of a regional formation with the conditions of Article XXIV.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5.2 GATT Panel Response to RTAs

5.2.1 EEC - Member States' Import Regimes for Bananas[14]

The bananas dispute is the longest running dispute in WTO history stretching back to pre-WTO days.[15] On 12 June 1992, Colombia, Costa Rica, Guatemala, Nicaragua and

[9] WT/DS32/R 3 June 1993. This case is commonly referred to as Bananas 1 as there were later actions involving the same parties on the same subject matter and will be denoted as such throughout the chapter.
[10] WT/DS34/R 31 May 1999 and WT/DS34/AB/R 22 October 1999.
[11] The Bananas 1 case illustrates how RTAs often implement GATT inconsistent measures and claim protection under Article XXIV of the GATT while the Turkey-Textiles case deals with specific measures adopted by a trade bloc in conflict with WTO provisions as opposed to the incompatibility of the RTA as a whole.
[12] Mathis *Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement* (2002) 87.
[13] *Ibid.*
[14] WT/DS32/R 3 June 1993.
[15] "United States Wins Dispute against EU Bananas Program" Press Release by US Trade Representative, 26 Nov 2008. Available at http://useu.usmission.gov/Dossiers/Trade/Nov2608_WTObananas.asap (accessed 28/12/08). It should be noted that the United States joined the case in 1997 in Bananas 3. The *Banana* disputes began in 1993 in *Bananas* 1. This dispute was re-submitted under the new dispute settlement mechanisms of the WTO in 1994 in *European Communities-Import Regime for Bananas* DS38R (*Bananas* 2) where the panel found like its predecessor that tariff preferences for the African, Pacific and Caribbean countries giving them

Venezuela[16] requested the European Economic Community[17] to hold consultations pursuant to Article XXII: 1 of the GATT in respect of import measures maintained on fresh bananas by individual member States of the EEC. These consultations did not result in a mutually satisfactory resolution of the matter thereby resulting in the complainant parties requesting the establishment of a GATT Dispute Settlement panel. That panel was established under the GATT dispute settlement mechanism of 1947 in February of 1993.[18]

5.2.1.1 Facts

Since 1988, the EEC had been the world's largest importer of bananas, followed by the United States and Japan. In 1991, the EEC imported some 4 million tons of fresh and dried bananas, approximately 38 per cent of world imports, compared to 2.9 million tons for the United States and 0.8 million tons for Japan.[19] Total supplies of fresh bananas in the EEC in 1991 amounted to some 3.7 million tons, two thirds of which originated in Latin American countries. Major suppliers of Latin American bananas to the EEC in 1991 were Ecuador, Costa Rica, Colombia, Panama and Honduras.[20] Domestic producers supplied approximately 19 per cent of EEC banana consumption, the main producing areas being Canary Islands, Martinique and Guadeloupe. Sixteen per cent were supplied by African, Caribbean and Pacific countries.[21] All EEC member states except Spain imported Latin American bananas although in widely varying degrees. Germany which accounted for approximately one third of EEC banana imports, by far the largest EEC market, imported almost all its bananas from

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duty free entry was contrary to Article 1 of the GATT. More *Banana* disputes followed in 1995, 1996, 1997 and 1999 (DS16, DS27, DS105 and DS158/R respectively). However, these largely dealt with the EC's modified banana import regime, issues of non-compliance and procedural aspects of the WTO dispute settlement mechanism rather than the grant of tariff preferences as such and will therefore not be included in this study.

[16] Hereinafter the complainants.

[17] Hereinafter the EEC.

[18] WT/DS32/R para 1.

[19] WT/DS32/R para 12.

[20] *Ibid.*

[21] Hereinafter ACP countries.

Latin America. Similarly, Belgium, Denmark, Ireland, Luxembourg and the Netherlands imported nearly exclusively from Latin American suppliers. In contrast, Spain did not import third country bananas, consuming bananas produced domestically in the Canary Islands. Domestically produced bananas were also consumed in France, Greece and Portugal. ACP bananas were primarily imported by the United Kingdom and France. Major suppliers of ACP bananas to the EEC in 1991 were Cameroon, Côte d'Ivoire, St. Lucia, Jamaica, St. Vincent and Dominica.[22]

On 31 December 1992, imports of bananas into the EEC were not subject to a common policy, but since 1963 the EEC had had a consolidated common external tariff on bananas of 20 per cent *ad valorem*. There were several different national import systems for bananas in the various member states of the EEC.[23] By virtue of Article 163(1) of the fourth Lomé Convention, imports of bananas from ACP countries entered the EEC duty free.[24] Under Protocol 5 of the fourth Lomé Convention, the EEC was committed to maintaining the traditional advantage of ACP banana suppliers in those markets. The Protocol stated: "no ACP State shall be placed, as regards access to its traditional markets and its advantages on these markets, in a less favourable situation than in the past or at present".[25] The successive Lomé Conventions, including the relevant Protocol concerning bananas, had been notified to the GATT.

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National restrictions applied by the EEC member States on imports of bananas from Latin America were placed on the list of residual restrictions of member States, as annexed to Council Regulation (EEC) No. 288/82 of 5 February 1982 relating to the common system

[22] WT/DS32/R para 12.
[23] WT/DS32/R para 13.
[24] WT/DS32/R para 14.
[25] *Ibid.*

applicable to imports.[26] This Regulation concerned trade measures applied by the member States prior to the creation of the EEC and maintained thereafter due to the lack of a common policy in respect of banana imports. The list of national restrictions was communicated to the GATT by the EC Commission in 1982 after Council Regulation (EEC) No. 288/82 had been published in the Official Journal of the EEC.[27] The notification was updated in 1987 following the Spanish and Portuguese accessions to the EEC. The various import regimes in the member States were due to expire on 30 June 1993. In February 1993, the EC Council adopted Regulation (EEC) No. 404/93 to establish a common market organization in the banana sector, including *inter alia* a new import regime.[28] The new regime was to take effect on 1 July 1993.

5.2.1.2 Party Arguments

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Because this was a multifaceted case, the issues will be discussed only in so far as they relate to Article XXIV. The complainants claimed that the banana import regimes of some EEC member States infringed the Most-Favoured-Nation[29] clause in Article I of the GATT by establishing different and discriminatory treatment of imports of bananas from Latin America.[30] They contended that the purpose of the existing regulations was to make market access conditions different for various contracting parties to which end use was made of discriminatory tariffs and quotas. The consequence of this discriminatory treatment was to preserve a number of privileges for a small group of suppliers to the disadvantage of the more efficient banana producers in the Latin American countries.[31] They contended that none of

[26] WT/DS32/R para 15.
[27] *Ibid.*
[28] *Ibid.*
[29] Hereinafter MFN.
[30] WT/DS32/R para 207.
[31] *Ibid.*

the exceptions to the MFN principle was applicable to the discriminatory treatment accorded by the challenged regimes. Furthermore, that neither Part IV[32] of the GATT nor Article XXIV empowered the abovementioned countries to discriminate against banana imports from Latin American countries.[33]

The complainants further argued that Article XXIV of the GATT relieved contracting parties of their non-discrimination obligation in the case of the formation of free trade areas and customs unions, within the meaning of paragraph 8 of Article XXIV.[34] However, there was no question in this case of a customs union or a free trade area between the ACP countries and their European trading partners. On the contrary, it was a question of a unilateral and non-reciprocal relationship which was not covered by Article XXIV of the GATT.[35] The parameters laid down by Article XXIV which authorized exceptional discriminatory treatment were precisely those that prevented the trade treatment granted by the European countries to the beneficiaries of the Lomé IV Convention from falling within the scope of that Article XXIV.[36]

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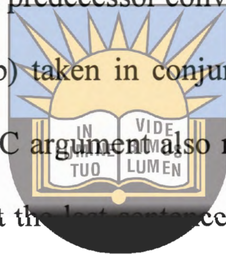
In turn, the EEC considered that this case was not merely directed to a market access issue but rather constituted an attack on the contractual scheme of preferential arrangements enshrined in the Lomé Convention.[37] Consequently, an attack on this contractual scheme would lead the panel beyond its terms of reference, particularly as a working group was established to review the Lomé IV Convention under the relevant GATT provisions just as

[32] Part IV of the GATT could not be invoked as an exception in this case as it envisaged differences in trade treatment between developed contracting parties and developing contracting parties and not between two groups of developing contracting parties as was the case of the preferential recipients on the one hand and the Latin American countries on the other.
[33] WT/DS32/R para 209.
[34] WT/DS32/R para 210.
[35] *Ibid.*
[36] *Ibid.*
[37] WT/DS32/R para 219.

previous working groups had reviewed earlier Lomé Conventions.[38] Citing in support an earlier and unadopted panel report, the EEC argued in the present instance that;

> "The legal certainty with respect to international contractual relations duly notified to the GATT would be severely affected, if many years after the coming into effect of an international convention which was examined by the appropriate GATT bodies, its conformity with the general agreement could be questioned anew".[39]

According to the EEC, this re-examination of well-established practice would breach the legitimate expectations of the parties to be able to maintain their trade agreements without modification.[40] The EEC contended that, contrary to the allegations of the complaining parties, the Lomé IV Convention, like its predecessor conventions, created a free trade area in the sense of Article XXIV:5(b) and 8(b) taken in conjunction with Part IV of the GATT (especially Article XXXVI:8).[41] The EEC argument also relied on the legal effect of Article XXIV: 7(b). The position taken was that the last sentence of the Article permits a free trade agreement with its notified features to be maintained and immune from later challenge as long as a recommendation to modify it had been addressed to the parties to the agreement.[42] Relying upon the First Lomé Convention working group review report[43] the EEC emphasised that the Lomé IV Convention complied with the obligation to eliminate duties and other restrictive regulations of commerce with respect to substantially all the trade with the ACP



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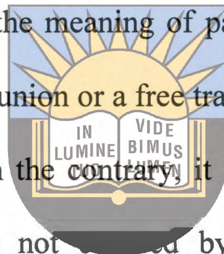
[38] *Ibid.*
[39] *Ibid.*
[40] The EEC underlined that the preferential systems between the United Kingdom and its dependent territories, as well as between France and its dependent territories were originally covered by Article I: 2 in combination with Annexes A and B of the GATT. Upon accession to the EEC, these preferences were still covered by Article XXIV: 9 at least as long as the other member states were able, under the transitional arrangements, to collect the difference between the preferential rate and the ordinary rate at the internal border. The EEC did not claim that this coverage which followed from explicit provisions contained in Article I: 2, Article XXIV: 9 and Annexes A and B of the GATT, continued on the same basis after the extension of the preferential treatment to the whole territory of the EEC (as far as tariffs were concerned). A customs union only had an outer customs limit and member states were, therefore, not equipped to collect duty differentials at internal borders. It was, thus not possible even from a purely technical point of view to continue the preferential treatment without jeopardizing the functioning of the EEC as a customs union. It should be clear, however, that the preferential treatment of products originating in ACP countries by the EEC was at the core of the Lomé IV Convention and its predecessor convention as it was the basis for the free trade area created between the ACP countries and the EEC. See WT/DS32/R paras 216-217.
[41] *Ibid.*
[42] *Ibid.*
[43] BISD 23S/46 (15 July 1976) para 4.

countries.[44] However, "in light of their development needs and the principles of Part IV of the GATT, the EEC had not demanded reciprocity in its trade with the ACP."[45]

5.2.1.3 Panel Findings

The Panel examined the EEC's argument that the tariff preferences on bananas granted by certain member States, although inconsistent with Article I, were covered by Article XXIV taken in conjunction with Part IV of the GATT. It held that Article XXIV relieved contracting parties of their non-discrimination obligation in the case of the formation of free trade areas and customs unions within the meaning of paragraph 8 of the Article.[46] In this case there was no question of a customs union or a free trade area between the ACP countries and their European trading partners. On the contrary, it was a question of a unilateral and non-reciprocal relationship which was not covered by Article XXIV of the GATT.[47] Accordingly, the panel interpreted Article XXIV: 5 and XXIV: 8 to mean that the contracting parties could deviate from their obligation under the GATT for the purpose of forming a customs union or free trade area "but not for any other purpose".[48] The Panel also held that Part IV of the GATT could not be invoked as an exception as it only envisaged differences in trade treatment between developed contracting parties and developing contracting parties and not between two groups of developing countries as was the case of the preferential recipients on the one hand and the Latin American countries on the other.[49] Therefore, conclusion was reached that:



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[44] Other Lomé working group reviews were cited to support the EEC position that a free-trade area could be formed according to Article XXIV without a reciprocity requirement all in light of Part IV of the GATT. See paras 227-228.
[45] *Ibid.*
[46] *Ibid.*
[47] WT/DS32/R para 210.
[48] WT/DS32/R para 358.
[49] WT/DS32/R para 209.

> "Legal justification for the tariff preference accorded by the EEC to imports of bananas originating in the ACP countries could not emerge from an application of Article XXIV to the type of agreement described by the EEC...but only from an action of the contracting parties under Article XXIV."[50]

For that reason the EEC banana import regime was held to be in conflict with Article 1 and to be unjustifiable under Article XXIV. However, the ruling in this case was largely academic since by the time of the panel's final report, the regime in question was about to expire.[51] .

5.2.2 Evaluation/Commentary

The following implications can be drawn from the *Bananas* 1 case:

- Where a party to a regional trade bloc attempts to invoke Article XXIV as the basis for extending selective preferences, this defence is subject to legal review according to the GATT/WTO dispute settlement procedures. This will be the case at least where the text of the agreement by its own terms fails to establish a requirement of reciprocity according to Article XXIV requirements.

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- An agreement which is intended to seek the Article XXIV exception should clearly state the elements of Article XXIV: 8 intended to be met by the arrangement, that is, clearly state that a free trade area or customs union is now being formed. This however clearly rebuts earlier practice of RTA review such as in the EEC Association of Overseas Territories for example, wherein the EEC had argued that declarations omitted from the agreement should not invalidate a finding of a free trade area formation since the course of practice under the agreement could indicate the formation of the free trade area.[52] It is submitted that an explicit declaration of this sort would minimize the possibility of creation of regional blocs that structure

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[50] WT/DS32/R para 372.

[51] Mathis *Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement* (2002) 87. See Hoekman and Kostecki *The Political Economy of the World Trading System: The WTO and Beyond* (2001) 80 for a brief analysis of the evolution of the *Banana* disputes.

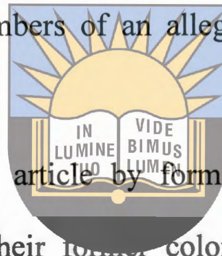
[52] See Mathis for an analysis of the EEC Association of Overseas Territories in relation to Article XXIV of the GATT at 57.

themselves in a way that seems to suggest that they are a trade bloc as envisaged and sanctioned by Article XXIV.[53]

- It is further submitted that the panel's refusal of the EEC's argument that the Lome Convention created a free trade area is a clear indication that reciprocity is a mandatory element of RTAs permitted by Article XXIV.[54]

Furthermore, it is submitted that the WTO Panel adopted a purposive and progressive interpretation of Article XXIV in this case by requiring:

- Reciprocity as between the members of an alleged RTA in order to be adjudged WTO-compliant; and
- Thereby avoiding abuse of the article by former colonial powers through trade discrimination favouring only their former colonies. The WTO Panel effectively delimited the scope of the Article XXIV exception to the MFN clause and thereby reinforced the position and character of the MFN clause as the cornerstone of the WTO trade regulatory framework. Moreover, it is submitted that a positive consequence and outcome of this interpretation is that the Panel has thereby ensured that the particular provisions of Article XXIV do not in practice become a gap or weakness thereby undermining multilateralism.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5.3 WTO RESPONSE TO RTAs

5.3.1 Turkey-Restrictions on Imports of Textile and Clothing Products[55]

[53] Mathis 98.
[54] It can also be noted that the panel in this case offered an alternative way forward for the EEC. In recognizing the economic and social effects of the EEC measures on the ACP banana exporting countries, the panel suggested that the EEC seek a waiver in terms of Article XXV: 5 of the GATT for the provision of an exception from the rules on economic and social grounds. See Myers *Banana Wars: The Price of Free Trade* (2004) 61.

5.3.1.1 Facts

On 12 September 1963, Turkey and the member States of the then European Economic Community (EEC) signed the Ankara Agreement which entered into force on 1 December 1964. The Ankara Agreement was the basis of the Association between Turkey and the European Communities envisaging that its objectives would be reached through a customs union which would be established in three progressive stages: preparatory, transitional and final.[56] The terms and conditions for the implementation of the transitional stage were defined in the 1970 Additional Protocol to the Ankara Agreement and in the 1971 Interim Agreement. The provisions of the Interim Agreement entered into force on 1 September 1971 and the Additional Protocol entered into force on 1 January 1973. These texts provided for an extended transitional period running over 22 years and foresaw the establishment of a customs union by the end of 1995.[57] On 6 March 1995, the Turkey-EC Association Council adopted Decision 1/95 which set out the rules for implementing the final phase of the customs union between Turkey and the European Communities. Article 12(2) of this Decision stated that:

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> "In conformity with the requirements of Article XXIV of the GATT, Turkey will apply as from the entry into force of this Decision, substantially the same commercial policy as the Community in the textile sector including the agreements or arrangements on trade in textiles and clothing".[58]

In order to apply what it considered to be "substantially the same commercial policy" as the European Communities on trade in textiles and clothing, Turkey's Council of Ministers issued two decrees as the basis for the alignment of Turkish commercial policy in textiles and clothing to that of the European Communities: Decree No. 95/6815 on *Surveillance and Safeguard Measures for Imports of Certain Textiles Products* with respect to products from

[55] *WT/DS34/R* 31 May 1999 and *WT/DS34/AB/R* 22 October 1999 (hereinafter *Turkey-Textiles*).
[56] WT/DS34/R para 2.10.
[57] DS34/R para 2.11.
[58] *Ibid.*

countries with which Turkey had concluded bilateral agreements and Decree No. 95/6816, concerning the *Surveillance and Safeguard Measures for Imports of Textile Products Originating in Certain Countries not Covered by Bilateral Agreements, Protocols and other Arrangements*, both of which were dated 30 April 1995 and published in the Turkish *Official Gazette* on 1 June 1995.[59]

In order to complete Decision 1/95 requirements for the "completion of the Customs Union", Turkey sent proposals to the relevant countries including India to reach agreements for the management and distribution of quotas under a double checking system. A standard formula was proposed for calculating the levels of quantitative restrictions on textile and clothing products to be introduced by Turkey vis-à-vis all third countries concerned.[60] On 31 July 1995 Turkey forwarded to the Indian authorities a draft Memorandum of Understanding on trade in the categories of textile and clothing products on which Turkey intended to introduce quantitative restrictions. India was invited to enter into negotiations with Turkey with the participation of the European Communities to conclude prior to the completion of the customs union, an arrangement covering trade in those products which would be similar to the one already existing between India and the European Communities. India took the position that the intended restrictions were in contravention of Turkey's multilateral obligations and declined to enter into discussions on the conditions proposed by Turkey.[61]

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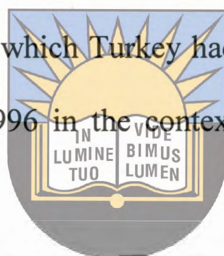
India further contended that the European Communities and Turkey were both parties to a multilateral treaty, the WTO Agreement. However, in their trade agreement they had committed themselves to harmonize their textiles and clothing policies towards third countries without regard to Turkey's obligations under the WTO Agreement. They had thus concluded a treaty which modified the WTO Agreement as between them in a manner that

[59] DS/WT34/R para 2.33.
[60] DS/WT34/R para 2.34.
[61] WT/DS34/R para 2.35.

affected the enjoyment of India's and other WTO Members' rights under the WTO Agreement.[62] Furthermore, India contended that in all areas in which their import duties or regulations differed, the European Communities and Turkey were able to implement border controls ensuring that only products originating in their respective territories would benefit from the preferential treatment under the trade agreement.[63] Turkey introduced as of 1 January 1996, quantitative restrictions on imports from India affecting 19 categories of textiles and clothing products.[64]

5.3.1.2 Party Arguments

India argued that the import restrictions which Turkey had imposed on textiles and clothing products from India since 1 January 1996 in the context of its trade agreement with the European Communities: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- were inconsistent with GATT Articles XI (General Elimination of Quantitative Restrictions) and XIII (Non-discriminatory Administration of Quantitative Restrictions) and Article 2.4 of the Agreement on Textiles and Clothing (ATC) and were not justified by Article XXIV of the GATT; and

- impaired benefits accruing to India under Articles XI and XIII of the GATT and Article 2.4 of the ATC.[65]

Further, India requested the Panel to recommend that Turkey bring its restrictions into conformity with its obligations under the GATT and the ATC, basing its rulings and recommendations on the following findings:

[62] WT/DS34/R para 6.8.
[63] WT/DS34/R para 6.113.
[64] DS34/AB/R para 2.
[65] WT/DS34/R para 5.1.

- Article XXIV: 5 of the GATT did not permit Members forming a customs union to impose Quantitative Restrictions (QRs) on imports from third Members;

- to the extent that there was a conflict between the provisions of Article 2.4 of the ATC (which permitted the European Communities but not Turkey to impose restrictions on imports of textiles and clothing products from India) and the provisions of Article XXIV: 8 of the GATT (which required Members forming a customs union to apply substantially the same restrictions on imports from third Members), the provisions of Article 2.4 of the ATC prevailed; and

- Turkey had not rebutted the presumption that its restrictions on imports of textiles and clothing impaired benefits accruing to India under Articles XI and XIII of the GATT and Article 2.4 of the ATC.[66]

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Subsidiarily, if the Panel were to accept the argument by Turkey that Article XXIV of the GATT provided a waiver from the obligations under Articles XI and XIII of the GATT and Article 2.4 of the ATC for measures necessary for the purposes of a customs union meeting the standards of Article XXIV, India requested the Panel to base its rulings on the following findings:

- for the purposes of the EC-Turkey trade agreement, an immediate harmonization of import restrictions on textiles and clothing products was unnecessary, because (a) the European Communities and Turkey were applying different import duties and regulations in respect of many sectors, policy instruments and trading partners and (b) in all areas in which their import duties or regulations differ, the European Communities and Turkey were able to implement border controls ensuring that only

[66] WT/DS34/R para 5.2.

products originating in the territories of the European Communities and Turkey benefit from the preferential treatment under the EC-Turkey trade agreement; and

- the type of agreement concluded between the European Communities and Turkey, that is an agreement providing for the establishment of a customs union at a future date, was not governed by the provisions of Article XXIV of the GATT and Turkey could therefore not invoke those provisions as justification for the restrictions.[67]

Turkey argued that:

- India had not sufficiently exhausted the avenues laid out by Article XXII of the GATT, Article 4 of the Dispute Settlement Understanding (DSU) and Article XXIV of the GATT in order to bring about an amicable settlement and adjustment;

- India had not complied with the procedural requirements of the ATC;

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- the Panel could not substitute itself for the Committee on Regional Trade Agreements (CRTA) which had not yet completed its examination of the Turkey-EC customs union;

- since Turkey argued that the measures forming the object of the complaint were a requirement of the Turkey-EC customs union, the Panel could not rule on their legality in the absence of agreed conclusions on the consistency of the Turkey-EC customs union with the obligations of Turkey and the European Communities under the GATT;

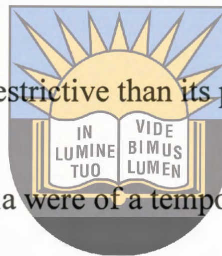
- Turkey had not acted inconsistently with its rights and obligations under the GATT and the ATC; and

[67] WT/DS34/R para 5.3.

- as required under Article 3.6 of the DSU, the parties to the dispute should seek a negotiated solution to the matter, taking into account India's commercial interests and Turkey's obligations arising from the Turkey-EC customs union.[68]

Turkey contended that Article XXIV of the GATT recognized WTO Members' right to form customs unions and that this right provided such a regional trade agreement with a "shield" from all other WTO obligations.[69] In the context of invoking Article XXIV of the GATT, Turkey argued that its customs union with the European Communities was consistent with Article XXIV in that:

- the new regime was overall less restrictive than its previous one;
- the restrictions challenged by India were of a temporary nature;
- the customs union has liberalized Turkey's trade with third countries; and
- the customs union would be deepened further including in the area of trade legislation.[70]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In particular, with reference to the import restrictions, Turkey argued that:

- Article XXIV: 5 provided a derogation from other GATT provisions in the case of the formation of a customs union and that the GATT did not prohibit all new restrictions which may be required by customs unions;[71]

[68] WT/DS34/R para 5.4.
[69] WT/DS34/R para 9.27.
[70] *Ibid.*
[71] *Ibid.*

- that these measures constituted a "requirement" (by the European Communities and also of Article XXIV) that it adopt the European Communities' common commercial policy, including the arrangements relating to trade in textiles and clothing;

- that there is no GATT-consistent alternative to these restrictions if it wanted to include textile and clothing products (which constituted 40 per cent of Turkey's exports to the European Communities) in the customs union; and

- that in this context, the WTO Agreement makes no distinction between the formation of a new customs union and accession to an existing customs union.[72]

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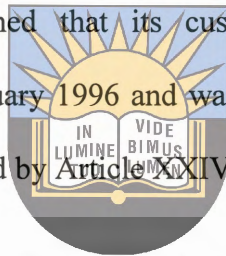
Turkey further argued that since it had formed a customs union with the European Communities which under the ATC was entitled to maintain import restrictions on the same 19 categories of textiles and clothing, Turkey's parallel import restrictions were not new restrictions in the sense of Article 2.4 of the ATC. For Turkey, the said measures were therefore not inconsistent with Article 2 of the ATC. Finally, Turkey claimed that India had not suffered any nullification of benefits, as its exports to Turkey had generally increased since the inception of the customs union.[73]

In response to Turkey's argument that the provisions of Article XXIV constituted a derogation or complete defence to all claims, India argued that the obligations under Articles XI: 1 and XIII of the GATT and 2:4 of the ATC were not modified by Article XXIV: 5(a) of GATT 1994, which, according to India, required Members forming a customs union not to

[72] WT/DS34/R para 9.28.
[73] WT/DS34/R para 9.29.

raise the general incidence of regulations of commerce imposed on trade with third Members.[74] As to Turkey's arguments that it was required to follow the EC commercial policy in the sector of textiles and clothing and that it had no alternative but to do so, India responded that the prohibitions of Articles XI and XIII of the GATT and Article 2.4 of the ATC were not modified by Article XXIV: 8(a) (ii) of the GATT. For India, pursuant to Article XXIV: 8(a) (ii), the European Communities and Turkey could have maintained different external textile policies at least for a certain period since their agreement was only an interim agreement and Turkey had not yet become a member of the European Communities. In reply, Turkey claimed that its customs union with the European Communities was complete as of 1 January 1996 and was not an interim agreement or any form of transitional agreement, as defined by Article XXIV.[75]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In response to Turkey's argument that the Panel should not substitute itself for the CRTA by examining the WTO compatibility of the Turkey-EC customs union, India agreed that it is not challenging the consistency of the Turkey-EC trade agreement with Article XXIV. Instead India was requesting the Panel to rule that Turkey did not have the right to impose discriminatory restrictions on imports of textiles and clothing from India, irrespective of whether Turkey's agreement with the European Communities was consistent with Article XXIV.[76] In response to Turkey's allegation that India's rights had not been nullified or impaired by its textile and clothing policy, India challenged the accuracy of the statistics submitted by Turkey and argued that, in any case, Article 3.8 of the DSU established that any breach of a GATT obligation constituted *prima facie* impairment and nullification of benefits,

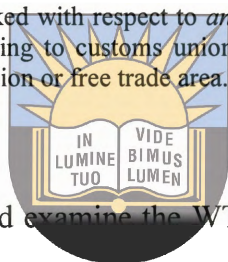
[74] WT/DS34/R para 9.30.
[75] *Ibid.*
[76] WT/DS34/R para 9.31.

which had been considered to include benefits denied due to changes in competitive opportunities.[77]

5.3.1.3 Panel Findings

As to the issue whether the WTO dispute settlement procedures could be invoked to challenge a measure adopted on the occasion of the formation of a customs union, the panel noted paragraph 12 of the Understanding on the Interpretation of Article XXIV of the GATT 1994 which states that:

> "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 agreement leading to the formation of a customs union or free trade area."[78]



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For the Panel this confirmed that it could examine the WTO compatibility of one or several measures "arising from" Article XXIV types of agreement. Consequently, the wording of paragraph 12 indicated that although the right of WTO Members to form regional trade arrangements was "an integral part" of the set of multilateral disciplines of the GATT and now the WTO[79], the DSU procedures could be used to obtain a ruling by a Panel on the WTO compatibility of any matters arising from such regional trade arrangements. The term "any matters" clearly included specific measures adopted on the occasion of the formation of a customs union or within the ambit of a customs union.[80] Thus:

> "we consider 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 Members to challenge measures adopted on the occasion of the formation of a custom union".[81]

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[77] *Ibid.*
[78] WT/DS34/R para 9.49.
[79] See a similar parallel drawn by the Appellate Body in *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India* WT/DS33/AB/R adopted on 23 May 1997 ("*US – Shirts and Blouses*") concerning the right to use transitional safeguard measures under the ATC at 16.
[80] WT/DS34/R para 9.50.
[81] WT/DS34/R para 9.51.

As to the question of how far-reaching a panel's examination of the regional trade agreement underlying the challenged measure should be, the panel noted that the Committee on Regional Trade Agreements (CRTA) had been established, *inter alia*, to assess the GATT/WTO compatibility of regional trade agreements entered into by Members, a very complex undertaking which involved 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.[82] It appeared to the panel that the issue regarding the GATT/WTO compatibility of a customs union, as such, was generally a matter for the CRTA since, as noted above, it involved a broad multilateral assessment of any such custom union, i.e. a matter which concerns the WTO membership as a whole.[83]

As to whether panels also have the jurisdiction to assess the overall WTO compatibility of a customs union, the panel recalled that the Appellate Body in *Guatemala – Anti-Dumping Investigation regarding Portland Cement from Mexico*[84] stated that the terms of reference of panels must refer explicitly to the "measures" to be examined by panels.[85] The panel considered that regional trade agreements may contain numerous measures all of which could potentially be examined by panels before, during or after the CRTA examination if the requirements laid down in the DSU were met. However, it was arguable that a customs union (or a free trade area) as a whole would logically not be a "measure" subject to challenge under the DSU.[86] The panel however decided that their examination in this case would be limited to the question whether in this case, on the occasion of the formation of the Turkey-EC Customs Union, Turkey was permitted to introduce WTO incompatible quantitative restrictions against imports from a third country assuming that the customs union in question

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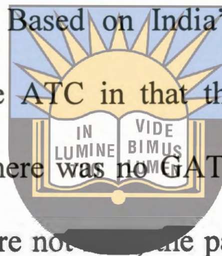
[82] The mandate of the CRTA can be found in WT/L/127. Available at www.wto.org.
[83] WT/DS34/R para 9.52.
[84] WT/DS60/AB/R 25 November 1998.
[85] WT/DS60/AB/R paras 76 and 86.
[86] WT.DS34/R paras 9.53.

was otherwise compatible with Article XXIV and refrained from any discussion as to the overall compatibility of the CU.[87]

5.3.1.3.1 Findings on claims under Articles XI and XII of the GATT and Art 2.4 of the ATC

The panel considered that the measures at issue, *prima facie*, imposed quantitative restrictions on imports and were only applicable to India. Given the absence of a defence by Turkey other than its defence based on Article XXIV of the GATT to India's claims that discriminatory import restrictions have been imposed, India made out a *prima facie* case of violation of Articles XI and XIII of the GATT.[88] Based on India's claim that the measures under examination violated Article 2.4 of the ATC in that they constituted new measures not authorized by the ATC and for which there was no GATT justification and Turkey's claim that the measures under examination were no[illegible] the panel held that these measures were inconsistent with the provisions of Articles XI and XIII of the GATT. Furthermore, coupled with the fact that the European Communities had similar restrictions in place when Turkey and the European Communities formed their customs union, and such restrictions were justified by Article XXIV of the GATT, the panel held that the measures under examination were Turkish measures and not EC measures, and found that the ATC did not provide any exception to the prohibitions against quantitative restrictions contained in Articles XI and XIII of the GATT.[89] Consequently, it was held that unless the measures under examination were justified by Article XXIV inconsistent with the provisions of Articles XI and XIII of the GATT and they would necessarily also violate Article 2.4 of the ATC.[90]



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[87] WT/DS34/R para 9.55.
[88] WT/DS34/R para 9.66.
[89] WT/DS34/R para 9.85.
[90] The Panel was aware of the Appellate Body statement in *EC - Bananas 3* that when two provisions were both applicable, a panel should proceed to apply the more specific provision first. However, such an exercise was not necessary here as what was examined was the relationship between Article XXIV and quantitative restrictions (either under Articles XI and XIII of the GATT or the ATC).

5.3.1.3.2 Findings on claims of Turkey's defence based on Article XXIV

The panel then deliberated on Turkey's defence to determine whether it rebutted what appeared to be *prima facie* evidence of violations of Articles XI and XIII of the GATT and Article 2.4 of the ATC. The panel examined the wider context of Article XXIV: 5(a) and 8(a) as well as the objects and purpose of the GATT and the WTO Agreement, together with the practice of GATT Contracting Parties and WTO Members regarding these provisions.[91] Based on the ordinary meaning of the terms and their immediate context, the panel found that the language of Article XXIV: 5(a) was not prescriptive as to whether a specific measure may be adopted on the occasion of the formation of a customs union. It found however that there was a basis for the provisions of sub-paragraph 5(a) to be informed by and interpreted in a manner consistent with the language of paragraph 4 against the raising of trade barriers. Consequently, the panel found that there was no legal basis in Article XXIV: 5(a) for the introduction of quantitative restrictions otherwise incompatible with the GATT/WTO; and that the wording of sub-paragraph 5(a) did not authorize Members forming a customs union to deviate from the prohibitions contained in Articles XI and XIII of the GATT or Article 2.4 of the ATC.[92] It also found that the terms of sub-paragraph 5(a) provided for a prohibition against the formation of a customs union that would be more restrictive on the whole than was the trade of its constituent members (even in situations where there are no WTO-incompatible measures).[93]

With regard to the specific relationship between Article XXIV and Articles XI and XIII (and Article 2.4 of the ATC), the panel considered that the wording of Article XXIV did not authorize a departure from the obligations contained in Articles XI and XIII of the GATT and

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[91] WT/DS34/R para 9.134
[92] *Ibid.*
[93] *Ibid.*

Article 2.4 of the ATC.[94] It based its findings on the nature of the conditional right established in Article XXIV as opposed to the clear and unambiguous obligation in Article XI prohibiting the use of quantitative restrictions, notwithstanding the specific contrary practice which had in the past existed in the sector of textiles and clothing of which the ATC represented a collective commitment to terminate.[95] It further considered that it was possible, and even necessary in order to avoid a conclusion that would lead to politically and economically absurd results, to interpret the provisions of Article XXIV in such a way as to avoid conflicts with the prescriptions of Articles XI and XIII of the GATT, and Article 2.4 of the ATC.[96]

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The panel noted that paragraphs 5 and 8 of Article XXIV provided parameters for the establishment and assessment of a customs union, but in doing so allowed flexibility in the choice of measures to be put in place on the formation of a customs union.[97] In this context the Panel recalled the use of the terms "substantially all the trade" and "substantially the same duties and other regulations of commerce".[98] It then ruled that, while the meaning of these terms was not precisely clear in relation to what and how much would constitute "substantially", clearly the standard in both cases was not "all".[99] These provisions did not, however, address any specific measures that may or may not be adopted on the formation of a customs union and importantly they did not authorize violations of GATT Articles XI and XIII, and Article 2.4 of the ATC. Moreover, the panel noted that paragraph 6 of Article XXIV provided for a specific procedure for the renegotiation of particular tariffs increased above their bindings upon formation of a customs union; no such provision existed for

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[94] WT/DS34/R para 9.188.
[95] *Ibid.*
[96] *Ibid.*
[97] WT/DS34/R para 9.189.
[98] *Ibid.*
[99] *Ibid.*

quantitative restrictions.[100] 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 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 negotiation of compensation connected with imposition of otherwise GATT inconsistent measures. The panel concluded that even on the occasion of the formation of a customs union, Members could not impose otherwise incompatible quantitative restrictions.[101]

Consequently, the Panel held that Turkey's introduction upon the formation of its customs union with the European Communities of quantitative restrictions on 19 categories of textile and clothing products was in violation of Articles XI and XIII of GATT and Article 2.4 of the ATC.[102]

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5.3.1.4 Appellate Body Findings[103]

On 26 July 1999, Turkey notified the Dispute Settlement Body (DSB) of its intention to appeal certain issues of law covered in the Panel Report and legal interpretations adopted by the Panel.[104] Turkey's key arguments on appeal were as follows:

- That the Panel erred in finding that Article XXIV of the GATT 1994 did not allow it to introduce, upon the formation of its customs union with the European Communities, quantitative restrictions on textile and clothing products which were inconsistent with Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC.
- That the Panel erred in presuming the existence of a conflict between, on the one hand, Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC and on the other, Article XXIV of the GATT 1994. That the Panel's reasoning was based on the

[100] *Ibid.*
[101] *Ibid.*
[102] WT/DS34/R para 9.192.
[103] WT/DS34 AB/R.
[104] WT/DS34/AB/R para 4.

incorrect presumption that the quantitative restrictions introduced by Turkey in the framework of its customs union with the European Communities were incompatible with Turkey's WTO obligations.[105]

• That Article XXIV was different from exceptions such as Articles XX and XXI of the GATT 1994. The right under Article XXIV to establish a customs union was an autonomous right and not an "exception" from other GATT obligations.[106]

• That the Panel ignored the proper relationship between Article XXIV and the general obligations under the GATT 1994; that the Panel did not properly interpret the ordinary meaning of the text of Article XXIV and in particular, the chapeau of paragraph 5 of that Article. The ordinary meaning of the chapeau of paragraph 5 demonstrated that Article XXIV conferred on WTO Members a right to enter into a customs union and to derogate under certain conditions, from their GATT obligations including but not limited to their obligations under Article I.[107]

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• Turkey argued that there was no textual support for the Panel's conclusion that Article XXIV permitted derogations from Article I, but not from other GATT provisions. The chapeau of Article XXIV: 5 states that "the provisions of this Agreement" shall not prevent the formation of a customs union, thereby covering all provisions of the GATT 1994, not just Article I.[108]

• Turkey claimed that the Panel's conclusion that Article XXIV: 5(a) does not authorize Members forming a customs union to deviate from the prohibitions

[105] WT/DS34/AB/R para 7.
[106] WT/DS34/AB/R para 9.
[107] WT/DS34/AB/R para 10.
[108] WT/DS34/AB/R para 12.

contained in Articles XI and XIII of GATT or Article 2.4 of the ATC was based on a number of legal errors.[109] First, Turkey argued that the Panel misinterpreted the ordinary meaning of Article XXIV: 5(a). Specifically, Turkey argued that the Panel ignored the chapeau to Article XXIV: 5. The chapeau clearly states that no GATT 1994 provision shall "prevent" the formation of a customs union as long as certain conditions set out in sub-paragraph 5(a) are satisfied. The Panel ignored the chapeau, and, as a result, came to the erroneous conclusion that Article XXIV: 5(a) does not "authorize or prohibit" the use of quantitative restrictions upon the formation of a customs union.[110]

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- Turkey further submitted that if it was not allowed to impose quantitative restrictions on the textile and clothing products at issue in this case, the European Communities would exclude 40 per cent of Turkey's exports from the customs union between Turkey and the European Communities, thereby leading to an inconsistency with Article XXIV: 8(a) (i).[111] Turkey would thus be exposed to a challenge that the proposed customs union did not cover "substantially all trade" and, therefore, is not consistent with Article XXIV.[112]

The Appellate Body's response mainly focused on the chapeau of paragraph 5 which the Appellate Body considered as the key provision in solving the case.[113] The Appellate Body construed the so called "two tier test" on the basis of an interpretation of the chapeau of paragraphs 4 and 5. It found that paragraphs 4 and 5 were linked together by the word "accordingly" found in the opening of paragraph 5. The Appellate Body concluded that

[109] WT.DS34/AB/R para 13.
[110] *Ibid.*
[111] WT.DS34/AB/R para 17.
[112] *Ibid.*
[113] WT/DS34.AB/R para 43.

"accordingly" can only be referring backwards to paragraph 4. As a consequence the chapeau of paragraph 5 could not be read in isolation from the purposive statement in paragraph 4.[114]

To determine the meaning and significance of the chapeau of paragraph 5, the Appellate Body looked at the text of the chapeau, and the context of paragraph 5. First, in examining the text of the chapeau to establish its ordinary meaning, the appellate body noted that the chapeau states that the provisions of the GATT 1994 "shall not prevent" the formation of a customs union. The Appellate Body read this to mean that the provisions of the GATT 1994 shall not make impossible the formation of a customs union. Thus, the chapeau made it clear that Article XXIV may, under certain conditions, justify the adoption of a measure which was inconsistent with certain other GATT provisions, and could be invoked as a possible "defence" to a finding of inconsistency.[115]

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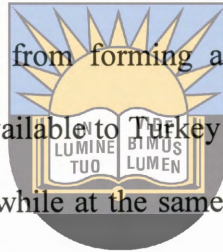
Second, in examining the text of the chapeau, the Appellate Body observed also that it states that the provisions of the GATT 1994 shall not prevent "the formation of a customs union".[116] This wording indicates that Article XXIV could justify the adoption of a measure which was inconsistent with certain other GATT provisions only if the measure was introduced upon the formation of a customs union, and only to the extent that the formation of the customs union would be prevented if the introduction of the measure were not allowed.[117] Accordingly, on the basis of this analysis of the text and the context of the chapeau of paragraph 5 of Article XXIV, the Appellate body was 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 "defense" was available only when two conditions are fulfilled. First, the party claiming the benefit of this defence must demonstrate that the measure at issue was

[114] *Ibid.*
[115] WT/DS34/AB/R para 45.
[116] *Ibid.*
[117] WT/DS34/AB/R para 46.

introduced upon the formation of a customs union that fully meets the requirements of sub-paragraphs 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue. Again, both of these conditions must be met in order to have the benefit of the defense under Article XXIV.[118]

The Appellate Body agreed 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.[119] As the Panel observed, there were other alternatives available to Turkey and the European Communities to prevent any possible diversion of trade, while at the same time meeting the requirements of sub-paragraph 8(a) (i).[120] For example, Turkey could adopt rules of origin for textile and clothing products that would allow the European Communities to distinguish between those textile and clothing products originating in Turkey, which would enjoy free access to the European Communities under the terms of the customs union, and those textile and clothing products originating in third countries, including India. In fact, the Appellate Body noted that Turkey and the European Communities themselves appeared to have recognized that rules of origin could be applied to deal with any possible trade diversion. Article 12(3) of Decision 1/95 of the EC-Turkey Association Council, which sets out the rules for implementing the final phase of the customs union between Turkey and the European Communities specifically provided for the possibility of applying a system of certificates of origin. A system of certificates of origin would have been a reasonable alternative until the quantitative restrictions applied by the European Communities are required to be terminated under the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[118] WT/DS34/AB/R para 58.
[119] WT/DS34/AB/R para 62.
[120] *Ibid.*

provisions of the ATC. Yet no use was made of this possibility to avoid trade diversion. Turkey preferred instead to introduce the quantitative restrictions at issue.[121]

For this reason, the Appellate Body concluded that Turkey was not, in fact, required to apply the quantitative restrictions at issue in this appeal in order to form a customs union with the European Communities.[122] Therefore, Turkey had not fulfilled the second of the two necessary conditions that must be fulfilled in order to be entitled to the benefit of the defence under Article XXIV. Furthermore, Turkey had not demonstrated that the formation of a customs union between Turkey and the European Communities would be prevented if it were not allowed to adopt these quantitative restrictions. Thus, the defence afforded by Article XXIV under certain conditions was not available to Turkey in this case, and Article XXIV did not justify the adoption by Turkey of these quantitative restrictions.[123]

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The Appellate Body concluded that the Panel erred in its legal reasoning by focusing on sub-paragraphs 8(a) and 5(a) and by failing to recognize the crucial role of the chapeau of paragraph 5 in the interpretation of Article XXIV of the GATT 1994, but upheld the Panel's conclusion that Article XXIV did not allow Turkey to adopt upon the formation of a customs union with the European Communities, quantitative restrictions on imports of 19 categories of textile and clothing products found to be inconsistent with Articles XI and XIII of the GATT 1994 and Article 2.4 of the ATC.[124] Consequently, the Appellate Body recommended that Turkey should bring its measures into conformity with GATT Articles XI, XIII and Article 2.4 of the ATC.[125]

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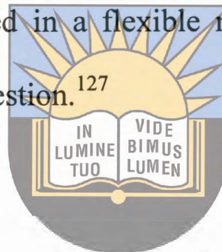
[121] *Ibid.*
[122] *Ibid.*
[123] WT/DS34/AB/R para 63.
[124] WT/DS34/AB/R para 64.
[125] WT/DS34/AB/R para 66.

5.3.2 Evaluation/Commentary

The *Turkey-textiles* reports reflect a rather common feature of disputes involving RTAs in the sense that the complaints in these cases seem to derive from a situation where certain measures are put in place by a RTA to the disapproval of other WTO Members. In outlining the Article XXIV elements drawn in the chapeau of paragraph 5, the Appellate Body has not only affirmed Article XXIV as exceptional in nature but it has also arguably informed the process of the examination required in order to qualify for the exception.[126] This can be seen to have varied from the approach followed by the panel which emphasized a preference for paragraph 8 definitions to be interpreted in a flexible manner in order to avoid conflict between the various GATT articles in question.[127]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Regarding the value of the strict interpretation adopted by the WTO Panel and Appellate Body, it is submitted that the interpretation adopted by both the Panel and the Appellate Body should be applauded for the fact that:

- It secures alignment with the intention of the drafters of GATT Article XXIV by ensuring that the formation of a RTA does not negatively impact the international trade interests of third countries through a real/effective increase of trade restrictions – which effectively translates into an impairment of the benefits envisaged by the third countries at the time of joining the WTO.
- The Panel and the Appellate Body in particular struck a good balance between the interests of WTO member states who might from time to time wish to invoke their right to economically integrate in terms of Article XXIV and the interests/legitimate

[126] Mathis *Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement* (2002) 217.
[127] See *Turkey-Textiles* Panel report para 9.147.

expectations of third countries in ensuring that their position/interest is not adversely affected by the RTAs' formation.

By adopting such an interpretation, these judicial structures of the WTO have, it is submitted, tried to ensure coherence (and avoid internal inconsistencies) between Article XXIV and other GATT provisions as well as between the application of the Article XXIV provisions and the overarching WTO policy objective to liberalise trade on a multilateral/global scale which underlies the creation of the Article XXIV exception.

Both *Turkey-Textiles* reports offered important interpretations of the controversial Article XXIV requirements:

- With regards to the paragraph XXIV: 8(a)(i) — Elimination of duties and other trade restrictions on "substantially all internal trade":

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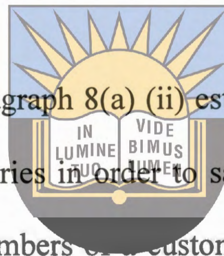
The Appellate Body noted that sub-paragraph 8(a) (i) establishes the standard for internal trade between constituent members in order to satisfy the definition of a customs union. It requires the constituent members of a customs union to eliminate "duties and other restrictive regulations of commerce" with respect to "substantially all the trade" between them. Neither the GATT Contracting Parties nor the WTO Members have ever reached an agreement on the interpretation of the term "substantially" in this provision.[128] What has been made clear, though, is that "substantially all the trade" is not the same as "all" the trade, and also that "substantially all the trade" is something considerably more than merely some of the trade.[129] The Appellate Body also noted that the terms of sub-paragraph 8(a) (i) provide that members of a customs union may maintain, where necessary, in their internal trade, certain restrictive regulations of commerce that are permitted under Articles IX through XV; and under

[128] Van Den Boscche *The Law and Policy of the World Trade Organization: Texts, Cases and Materials* (2005) 654.
[129] See *Turkey-Textiles* Appellate Body report para 48.

Article XX of the GATT 1994.[130] Thus, in agreement with the Panel, the terms of sub-paragraph 8(a) (i) offer "some flexibility" to the constituent members of a customs union when liberalizing their internal trade in accordance with this sub-paragraph. However, the Appellate Body cautioned that the degree of "flexibility" that sub-paragraph 8(a) (i) allowed was limited by the requirement that "duties and other restrictive regulations of commerce" be "eliminated with respect to substantially all" internal trade.[131]

- With regards to Article XXIV: 8(a) (ii) — "substantially the same duties and other regulations on external trade":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The Appellate Body noted that sub-paragraph 8(a) (ii) establishes the standard for the trade of constituent members with third countries in order to satisfy the definition of a "customs union".[132] It requires the constituent members of a customs union to apply substantially the same duties and other regulations of commerce to external trade with third countries. The constituent members of a customs union are thus required to apply a common external trade regime relating to both duties and other regulations of commerce. However, sub-paragraph 8(a)(ii) does not require each constituent member of a customs union to apply the same duties and other regulations of commerce as other constituent members with respect to trade with third countries; instead, it requires that substantially the same duties and other regulations of commerce shall be applied. In this instance, the Appellate Body agreed with the Panel that the ordinary meaning of the term "substantially" in the context of sub-paragraph 8(a) appears to provide for both qualitative and quantitative components. The expression "substantially the same duties" and "other regulations of commerce" as applied by each of the Members of the

[130] Van Den Boscche 654.
[131] *Ibid.*
[132] *Turkey-Textiles* Appellate Body report para 49.

customs union" would appear to encompass both quantitative and qualitative elements, the quantitative aspect being more appropriately emphasized in relation to duties.[133]

The Appellate Body agreed with the Panel that the terms of Article XXIV: 5(a), as elaborated and clarified by paragraph 2 of the Understanding on the Interpretation of Article XXIV provides:

> ... 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.[134]

5.4 Conclusion

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The case law above offers some clarity on the subject of RTAs and the Article XXIV exception, especially with respect to how the exception has evolved, how and when it can be raised to relieve a country from its WTO obligations, and the interpretation of its most controversial concepts. The primary goal of the exception, as reflected in Article XXIV: 4 and the Understanding on the Interpretation of Article XXIV, is the promotion of trade.[135] The parties to an RTA must grant each other special trade preferences that are not offered to other WTO Members. The establishment of an RTA, therefore, creates the potential for positive effects on internal trade between the parties (who benefit from the preferences) and negative effects on external trade with other Members (who are excluded from the preferences).[136] To secure an overall expansion of world trade, the exception in Article XXIV: 5 is designed to maximise the internal trade liberalising effects of an RTA and to minimise its external trade-restricting effects.[137]

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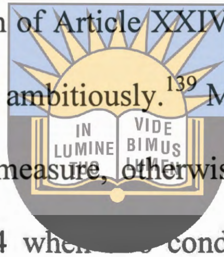
[133] Van Den Boscche 655.
[134] *Turkey-Textiles* Appellate Body report para 53-55
[135] Mitchell and lockhart "Challenges and Prospects for the WTO". Available at www.wto.org (accessed 12/08/08).
[136] Mavroidis "If I Dont Do It, Somebody else Will (or Wont)". Available at http://collections.europarchive.org/tna/20050908065249/h (accessed 02/08/08).
[137] *Ibid.*

As already noted, the most fundamental principle of the GATT is non-discrimination: one member must not treat or be treated more or less favourably than the other. In view of this basic principle it is not surprising that the panel in *Bananas* 1 found the tariff preferences granted to the ACP countries to be in breach of the GATT. The rulings in *Turkey-Textiles* can be contrasted with the findings delivered in *Banana*s 1. While the *Bananas* 1 panel report made reference to the necessity of a *prima facie* review of a trade agreement's provisions, for those facts at hand, no more was required.[138] Arguably, the same can be said of the facts presented in *Turkey-Textiles* but rather than take a narrow view of the panel's authority to oversee a regional formation's invocation of Article XXIV, the Appellate Body in particular has determined a panel's obligation more ambitiously.[139] More importantly, what can be seen from the *Turkey-Textiles* case is that a measure, otherwise GATT inconsistent, is justified under Article XXIV of the GATT 1994 when two conditions are fulfilled: first, that the measure be introduced upon the formation of a RTA that meets the requirements of Article XXIV: 8(a) and Article XXIV: 5(a) and the second, that without the introduction of the measure concerned, the formation of the RTA would be impossible.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[138] Mathis 216.
[139] *Ibid.*

CHAPTER 6

ASSESSING THE WTO-CONSISTENCY OF RTAs: THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY

6.1 Introduction

Article XXIV of the General Agreement on Tariffs and Trade[1] contains strict criteria for the formation of those regional trade groupings recognized by the GATT. Despite being offered legitimate Most-Favoured Nation[2] deviation, regional blocs remain exclusive entities in the sense that they favour some members to the exclusion of others outside the RTA. Nevertheless, the World Trade Organization[3] has provided guidelines that seek to ensure that these regional formations do not become protectionist tools. The GATT having had no institutional foundation found it hard to enforce and regulate its provisions.[4] As a consequence thereof many countries could default on their obligations to the GATT. The lack of harmonization of RTA provisions with GATT rules has provided opportunities or loopholes for contracting states to develop policies that could be used to protect their economies at the expense of those outside regional trade agreements.

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An analysis of the Southern African Development Community[5] will be undertaken in this chapter through an examination of its internal and external policies in order to determine its consistency with Article XXIV. Both the terms of SADC as a regional trade bloc and SADC as a Free Trade Area[6] will be explored. However, it should be noted that since the SADC

[1] Hereinafter the GATT.
[2] Hereinafter MFN.
[3] Hereinafter the WTO.
[4] Jackson submits that the widespread development of RTAs has been one on the more difficult institutional problems for the WTO. Under the GATT this was already a major problem because the legal principles contained therein, particularly the provisions of Article XXIV appeared to be inadequate to prevent potential abuses. See Jackson *The World Trade Organization: Constitution and Jurisprudence* (1998) 54.
[5] Hereinafter SADC.
[6] Hereinafter SADC FTA.

FTA is still in infancy, an accurate analysis of its terms of compliance may be premature.[7] However, considering that SADC members have been implementing the Trade Protocol for more than seven years, it is reasonable to assess the impact and outcome of that implementation process at this stage. The discussion will not deal with the economics of SADC as a trading entity but rather largely focus on trying to uncover whether there exists any disparities between the bloc as envisaged by the GATT and the actual application of Article XXIV procedures within the grouping.

6.2 SADC: An Overview

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The rapidly evolving process of global integration and economic liberalization has accelerated the internationalization of trade, investment flows and information transfers.[8] These changes have given rise to questions about how states can best position themselves to compete in the increasingly interdependent international environment.[9] In the South, one response to these questions has been the recourse to regional formations. Amongst developing countries SADC has become one of the most important groupings to emerge.[10]

The SADC's regional cooperation and integration is based on historic, economic, political, social and cultural factors.[11] SADC has been in existence since 1980 when it was formed as

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[7] Refer to para 6.3 for an analysis of the SADC Trade Protocol.
[8] Bertelsmann-Scott and Mutschler (eds) "MERCOSUR and SADC Regional Integration in the South" *The Southern African Institute of International Affairs Report No 15* (1999) 1.
[9] *Ibid.*
[10] Developing countries have been part of the global trade policy development process since the inception of GATT although they have not played a significant role in shaping or establishing international trade policy. Because of this fact, fundamental interests of developing countries did not receive substantial consideration during the GATT negotiation process and outcome. This realization served as the driving force behind the developing countries to finally and formally seek a focus on their needs and interests in the latest Round of the WTO Round of Trade Negotiations, the Doha Developmental Agenda (DDA). The power of developing countries first became evident at the fifth WTO Ministerial conference held in Cancun, Mexico in September 2003. At this meeting the European Union insisted that the so called "Singapore issues" (trade facilitation, rules on investment, transparency in government procurement and competition policy) be included as part of the DDA but developing countries insisted that these issues would come at substantial costs. An impasse occurred, negotiations broke down and the meeting came to an abrupt end. See Crump and Maswood (eds) *Developing Countries and the Global Trade Negotiations* (2007) 1-2.
[11] Mudzonga "Implementation Challenges for the SADC FTA: Tariffs and Non-Tariff Barriers" in Oesterdiekhoff (ed) *Liberalising Trade in Southern Africa: Implementation, Challenges for the 2008 SADC FTA*

an alliance of nine majority ruled states in Southern Africa. SADC evolved from the Southern African Development Coordination Conference (SADCC) with the main aim of coordinating development projects in order to lessen economic dependence on the then apartheid South Africa.[12] The founding member states are Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe. South Africa joined when it abandoned apartheid rule in 1994. The transformation of the organization from a coordinating conference into a development community took place in August 1992 in Windhoek, Namibia where the SADC Treaty[13] was signed at a Summit of Heads of State and Government thereby giving the organization legal character.

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and Beyond 6-7 August (2008) 15. In the Southern African context, regionalism was widely viewed as the only way in which the continent could be rescued from the deleterious effects of colonial and neo-colonial influence. According to Gibb, the appeal of regionalism was for many policy makers in Africa intuitive because of the extreme geographical fragmentation of the countries that make up the sub-continent combined with the economic and political marginality of many. See Gibb "The Challenge of Regional Integration in Southern Africa" 2006/7 *SA Yearbook of International Affairs* 75.

[12] The formation of the Southern African Development Coordination Conference (SADCC) was a culmination of a long process of consultations. Towards the end of the 1970s it had become clear to the leaders of the region that having just a national flag and anthem would not meet the needs of the people for improved living standards. Secondly, the positive experiences gained in working together in the group of frontline states to advance the political struggle had to be translated into broader cooperation in pursuit of economic and social development. See SADC Profile available at http://www.sadc.int (accessed 05/07/09). Ramsay submits that SADC in many terms was fortunate to be able to draw on the solid foundation created by SADCC. Infrastructure development projects undertaken by SADCC have contributed to a large extent to overcoming a number of significant constraints to regional development and long years of working together helped forge a strong sense of regional identity and common belonging. The critical factor in the economics of integration within SADC is that tangible benefits accrue to all participating countries and this is a real challenge for SADC. See Ramsay "Challenges and Prospects for Regional Integration Strategies in Southern Africa" *Regional Economic Integration and the Globalization Process: Report on the Proceedings of the Southern African Conference, Windhoek 10-13 June* (1998) 89. See further Osode "The Southern African Development Community in Legal Historical Perspective" 2003 *Journal for Juridical Science* 1 for an analysis of institutional history of the SADC. His study finds that SADC's poor track record in delivering on its institutional objectives is attributable to four closely related factors: regional trade imbalances; South African equivocation towards economic integration; lack of political will and/or stability; and an unwillingness on the part of SADC Member States to surrender some elements of their economic sovereignty. Similar reasons advanced for SADC's lack of progress can be found in Bertelsmann-Scott and Mutschler (eds) "MERCOSUR and SADC Regional Integration in the South" *The Southern African Institute of International Affairs Report No 15* (1999) 1: namely that there is a lack of political compatibility, absence of common economic perspectives, personality clashes between Heads of States, a lack of political will, emphasis on expanding as opposed to deepening SADC, limited capacity to manage complex policy and technical issues, political and bureaucratic disjuncture, suspicion of South Africa's regional dominance, distribution costs and benefits and the absence of business as a driver of regional integration as opposed to political motivations.

[13] SADC was established under Article 2 of the SADC Treaty to spearhead economic integration of Southern Africa. See SADC Profile. Available at http://www.sadc.int (accessed 05/07/09).

Provided for in the SADC Treaty are a number of organisational objectives. With these objectives in mind, the signatories of the SADC have agreed that underdevelopment, exploitation, deprivation and backwardness in Southern Africa can only be overcome through economic cooperation and integration.[14] In pursuit of this agenda, SADC has adopted certain milestones to facilitate the attainment of its objectives. These include the establishment of a Free Trade Area. The Regional Indicative Strategic Development Programme (RISDP)[15] envisages a Customs Union by 2010, a Common Market by 2015, a Monetary Union by 2016 and a single currency by 2018.[16] The SADC Free Trade Area was launched on August 2008 in Sandton, South Africa during the 28th Summit of Heads of State and Government.

6.2.1 The SADC Free Trade Area

Independence, security, regional solidarity and the fight against apartheid were the original motives for the establishment of SADC. Today SADC's main goals are to forge political interests and support greater trade and investment flows between members.[17] The SADC Treaty has 22 protocols one of which is the SADC Protocol on Trade.[18] The Trade Protocol was signed on 24 August 1996 and came into effect on 25 January 2000. However, actual implementation of the provisions of the trade protocol commenced on 1 September 2000. On the 2nd of August 2004, SADC members notified the trade protocol to the WTO under Article XXIV: 7 (a) of the GATT as an agreement aimed at the establishment of a FTA.[19] The terms of reference for the examination of the trade protocol were adopted by the WTO Council for

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[14] Article 5 of the SADC Treaty.
[15] The RISDP covers all programmes of SADC but when it comes to trade-specific issues, the SADC Trade Protocol of 1996, as amended in 2000 is the key document.
[16] See SADC Profile. Available at http://www.sadc.int (accessed 05/07/09).
[17] "Is the SADC FTA a Reality?" Available at http://www.sadc.int/fta (accessed 05/07/09).
[18] Hereinafter the Trade Protocol.
[19] See WT/REG176/N/1/REV.1. Available at the SADC official website http://www.sadc.int.

Trade in Goods on 1 October 2004[20] and the text of the Trade Protocol and the Amendment Protocol circulated to WTO member states.[21]

The Trade Protocol sets out an eight-year transition period after entry into force of the protocol for the completion of a SADC FTA.[22] The launch of the SADC FTA in August 2008 will see producers and consumers no longer paying import tariffs on an estimated 85% of all trade in Community goods in the initial 12 member countries while the remaining 15% on what has been classified as sensitive products is set to be eliminated by 2012.[23] However, it is reported that the SADC is either already facilitating the movement of goods or is shortly going to do so through:

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- Harmonization of customs procedures and customs classifications;
- Increased custom cooperation;
- Reducing cost by introducing a single standardised document (Single Administrative Document) for customs clearance throughout the region;
- Establishing one-stop border posts which will cut the time spent at border posts in half. Currently three are pilots at the border of Mozambique and Zimbabwe (Forbes-Machipanda), South Africa and Mozambique (Lebombo Ressaro Gercia) and Zimbabwe and Zambia (Chirundu); and
- Making transhipment easier by enabling a single bond to be used when transporting goods across several borders within the community.[24]

[20] See SADC's Terms of Reference document WT/REG176/3. Available at http://www.sadc.int.
[21] See The WTO Secretariat "Factual Presentation: Protocol on Trade in the Southern African Development Community" WT/REG176/4, 12 March 2007. Available at http://rtais.wto.org/rtadocs/45/FactualDocs/English/WT-Reg176-4e.doc#FP3 (accessed 05/07/09).
[22] Article 3.1 (b) of the SADC Trade Protocol.
[23] See SADC Profile. Available at http://www.sadc.int (accessed 05/07/09).
[24] "Is the SADC FTA a Reality?" Available at http://www.sadc.int/fta (accessed 05/07/09).

6.3 The SADC Trade Protocol

The SADC Trade Protocol aims to further liberalize intra-regional trade in goods and services on the basis of fair, mutually equitable and beneficial trade arrangements and to ensure efficient production within SADC reflecting the current and dynamic comparative advantages of its members.[25] In keeping with these objectives the Protocol has made provisions for the elimination of tariffs and non-tariff barriers between members together with the implementation process.

6.3.1 Intra-SADC Trade in Goods

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According to Article 11 of the Trade Protocol, members shall accord immediate and unconditional National Treatment to all goods traded within the Community by granting them the same treatment as goods produced in their respective countries in respect of all laws, regulations and requirements affecting their internal sale, purchase, transportation and distribution etcetera.[26] Article 3 provides for the elimination of tariffs on intra-SADC Trade. The elimination of trade barriers shall be achieved within a time frame of eight years from the entry into force of the trade protocol. However, member states who feel they may be or have been adversely affected by the removal of tariffs and non tariff barriers (NTBs) may be granted a grace period to afford them additional time for the elimination of tariffs. Further, different tariff lines may be applied within an agreed time frame for different products in the process of elimination of tariffs and NTBs.[27] However, it is submitted that the Protocol does not go far enough in recognizing the different needs of the different states. SADC represents a group of countries whose sizes are highly disparate with individual economic development at very different stages. There exists a similarly wide discrepancy in member states' Gross

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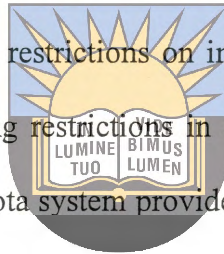
[25] Article 2 of the SADC Trade Protocol.
[26] Article 11 of the SADC Trade Protocol.
[27] Article 3 of the SADC Trade Protocol.

National Product (GNP) and these discrepancies represent the root causes of the pronounced differences between member states' industrial development, their value added export potential, their quality and quantity of socio-economic infrastructure as determinants of their national competitiveness and their respective national monetary demand market size.[28]

Article 4 calls for a phased reduction and eventual elimination of import duties and charges having an equivalent effect. It prevents the parties from raising existing duties beyond their level at the Trade Protocol's entry into force and allows for the imposition of across the board internal charges and application of fees commensurate to services rendered.[29] Similarly, the parties cannot introduce new quantitative restrictions on imports of goods originating from member states and will phase out existing restrictions in accordance with their agreement schedules.[30] The parties may apply the quota system provided that the tariff rate under such a quota system is more favourable than the rate applied under the protocol. Further, the parties undertake to adopt policies and implement measures to eliminate all existing forms of non-tariff barriers to trade and refrain from imposing new ones.[31] A committee of trade ministers has been created and is responsible for adopting measures necessary to facilitate adjustments and review measures adopted by member states. Article 5 prohibits member states from applying export duties on goods to other member states. However, it does not prevent them from applying export duties necessary to prevent the erosion of any prohibitions or restrictions which apply to exports outside the Community.[32] Article 9 provides for general exceptions. However, these exceptions are subject to the requirement that they not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between member states or a disguised restriction on intra-SADC trade.



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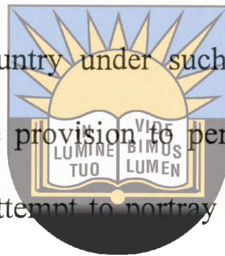
[28] Ramsay "Challenges and Prospects for Regional Integration Strategies in Southern Africa" *Regional Economic Integration and the Globalization Process: Report on the Proceedings of the Southern African Conference* Windhoek 10-13 June (1998) 89.
[29] Article 4 of the SADC Trade Protocol.
[30] Article 7 of the SADC Trade Protocol.
[31] Article 6 of the SADC Trade Protocol.
[32] Article 5 of the SADC Trade Protocol.

6.3.2 Trade Relations between Member States and Third Countries

The Trade Protocol allows members to enter into new preferential trade arrangements between themselves, maintain preferential trade and other trade related arrangements existing at the time of the entry into force of the Protocol provided that such arrangements are not inconsistent with the provisions of the Protocol.[33] Though the Trade Protocol calls on member states to accord MFN treatment to one another, it does not prevent member states from granting or maintaining preferential trade agreements with third countries provided that such trade arrangements do not impede or frustrate the objectives of the Protocol and that MFN treatment granted to the third country under such treatment is extended to other member states.[34] Thomas opines that the provision to permit the existence of preferential arrangements and MFN treatment is an attempt to portray an open regional arrangement as opposed to a closed regional arrangement like the European Union which has been perceived to be a closed regional arrangement in the sense that there is a lot of protectionism against third countries especially with their common agricultural policy.[35]



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6.3.3 Customs Procedures

Member States must take appropriate measures[36] including arrangements regarding customs administration cooperation to ensure that the provisions of the Trade Protocol are effectively and harmoniously applied. According to Annexure III[37] of the Protocol, Member States shall take the necessary measures to facilitate the simplification and harmonisation of trade documentation and procedures.[38] The products imported into and exported from a Member

[33] Article 27 of the SADC Trade Protocol.
[34] Article 28 of the SADC Trade Protocol.
[35] Thomas "Regional Cooperation for Trade Development: The SADC Trade Protocol" in Balch and Caffey (eds) *Regional Cooperation: The Role of Parliament in SADC Today* (1997) 13.
[36] As provided in Annexure II of the Trade Protocol.
[37] This is the annexure dealing with simplification and harmonization of trade documentation and procedures.
[38] Article 14 of the SADC Trade Protocol.

State shall enjoy freedom of transit within the community and will be subject to the payment of the normal rates for services rendered.[39]

6.3.3.1 Rules of Origin

Article 12 of the trade protocol concerning rules of origin (RoOs) for products to be traded between the member states has been repealed by Annex 1 of the Amendment Protocol on Trade. Rules of origin are necessary tools in an FTA used to guard against trade deflection, whereby goods and services tend to enter an FTA via the member with the lowest external tariffs. RoOs are then used to identify products that qualify for tariff preferences under an FTA, thereby ensuring that only products originating in member states (to such a degree as members determine) enjoy applicable tariff preferences.[40]

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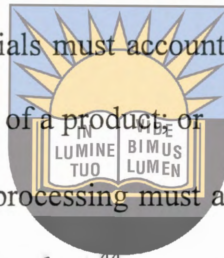
The RoOs chapters of trade agreements employ various methodologies to determine local origin. The methodologies have their own inherent advantages and weaknesses, and are often vulnerable to the political economy and strategic interests of the contracting parties.[41] Local origin is based on the "wholly produced" requirements where a product is completely produced (or made up) in the exporting country or undergoes "substantial transformation" in

[39] Article 15 of the SADC Trade Protocol.
[40] Hansohm and Shilimela "Progress in Economic Integration within SADC" 2006 *Monitoring Regional Integration in Southern Africa Yearbook* 6. RoOs are often negotiated between vastly different trading partners, which have unique comparative advantages and invariably vested interests. Therefore, they are sometimes used to further protectionist interests. Restrictive RoOs reduce competition in the domestic market, and undermine the regional and international competitiveness of producers in countries with poor availability of materials. They raise entry barriers to new investors and harm retailers and consumers, who are faced with higher prices and less variety, or even a complete unavailability of some final goods. See Nauman "Preferential Rules of Origin in SADC: A General View and the State of Play in Recent Negotiations" in Oesterdiekhoff (ed) *Liberalising Trade in Southern Africa: Implementation, Challenges for the 2008 SADC FTA and Beyond 6-7 August* (2008) 24.
[41] *Ibid.*

line with specified criteria.[42] These criteria can be based on a change in tariff-heading (CTH), a specific processing (SP) requirement or a minimum percentage of value-added (VA).[43]

The revised RoOs Protocol was finalised at the end of October 2004 and implemented with effect from 1 January 2005. Since 2005, the RoO of products in some sectors remain subject to review and negotiation among SADC members. The originally agreed RoOs were that:

- the goods must have undergone a CTH, meaning that the non-originating materials used can be classified under a different (HS four-digit) heading to that of the product;
- the value of non-originating materials must account for no more than 60 per cent of all materials used in the production of a product; or
- the local VA resulting from local processing must account for at least 35 per cent of the ex-works (factory) price of the product.[44]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The revised and current rules combine CTH, VA and SP methodologies, which are tailored to specific products. Since their implementation, agreed changes have been made to the treatment of certain agricultural products, as well as some electrical/household appliances and

[42] *Ibid.*

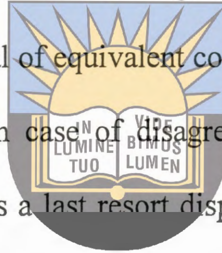
[43] The CTH test is based on the harmonised system (HS) nomenclature used widely to classify and record international trade flows, especially in the application of import tariffs. "Substantial transformation" takes place when a product is classified under a different heading from its local or non-originating materials. In other words, processing that transforms materials into goods of another heading is considered sufficient to confer origin. The main drawback of this methodology is the different burdens imposed on different sectors and producers, as a CTH in one product sector will be different to the others. This methodology therefore raises concerns about equity and fairness if used in isolation of other methods, and does not consider the dynamics facing specific sectors. The SP (also referred to as the technical test) sets specific local processing requirements, and must therefore be negotiated on a line-by-line basis. A VA test can specify local content or maximum foreign content. One variant uses the final factory selling (or 'ex-works') price as the denominator, and determines local VA by measuring all local processing including mark-up against this denominator. See Nauman *Preferential Rules of Origin in SADC: A General View and the State of Play in Recent Negotiations* (2008) 24.

[44] *Ibid.*

automotive products.[45] The textiles and clothing section is particularly sensitive and no agreement had been reached as of the most recent technical meeting.[46]

6.3.4 Dispute Settlement Procedures

Article 32 of the trade protocol set forth a dispute settlement mechanism between SADC members. It encouraged member states to agree on the interpretation and application of the trade protocol: that the settlement of any dispute among member states shall whenever possible imply removal of a measure not conforming with the provisions of the trade protocol.[47] Failing a settlement, withdrawal of equivalent concession may be implemented by the member state suffering the injury. In case of disagreement member states may take recourse to a panel of trade experts and as a last resort disputes regarding the interpretation and application of the Protocol shall be settled in accordance with Art 32 of the SADC treaty.[48]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However, Article 32 of the Trade Protocol has been amended by Article 5 of the Amendment Protocol substituting it with the following:

> "The rules and procedures of Annex VI [newly inserted annex] shall apply to the settlement of disputes between Member States concerning their rights and obligations under this Protocol."[49]

It is noteworthy that the procedures for the settlement of disputes between the Parties under the Protocol are modelled on the structure of the WTO Understanding on Rules and

[45] "Audit of the Implementation of the SADC Protocol on Trade" Submitted by the Services Group, Gaborone, Botswana (2008) 2. Also available at http//www.mic.gov.mz/docs/rei/IntRegional/Audit%20Report%20DRAFT%FINAL.pdf (accessed 23/08/09).

[46] *Ibid.*

[47] Article 32(2) of the SADC Trade Protocol.

[48] Article 32(6) of the SADC Trade Protocol.

[49] Article 5 of Annex VI of The Amendment Protocol on Trade of 2000.

Procedures Governing the Settlement of Disputes.[50] The rules provide that failing initial consultations, disputes can be referred to a Panel established by the Registrar of the SADC Tribunal consisting of members chosen by the disputing Parties from a roster. In case of disagreement over panellists selected, they will be selected by lot by the SADC Executive Secretary.[51] The final Panel report is to be presented to the disputing Parties and transmitted to the Committee of Ministers responsible for trade matters (CMT) which will adopt it unless it decides otherwise by consensus. The Party complained against will then have a reasonable period of time (not exceeding six months) to implement the Panel's recommendations. If the complaining Party considers that the Party complained against has failed to bring the contested measure into conformity with the Protocol, it can ask the CMT for authorization to suspend concessions.[52] The CMT will grant authorization unless it decides otherwise by consensus that the level of suspension can be brought to the original panel for arbitration by the Party complained against.

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However there exists a potential overlap between the SADC dispute settlement mechanism on trade and other international dispute settlement regimes. Pauwelyn has examined this potential overlap and essentially asks whether it is conceivable that a single dispute between SADC members may fall under the jurisdiction of both the SADC dispute settlement mechanism and the jurisdiction of another international court or tribunal.[53] More specifically is the question of the overlap between the SADC dispute settlement procedures and the WTO

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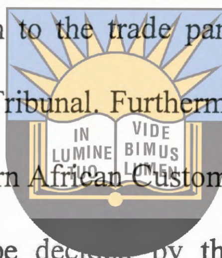
[50] See WTO doc WT/REG 176/4 12 March 2007 pg 24 for a synopsis of the SADC dispute settlement structure. Available at http://rtais.wto.org/rtadocs/45/FactualDocs/English/WT-Reg176-4e.doc#FP3 (accessed 05/07/09).

[51] Annex VI of The Amendment Protocol on Trade of 2000.

[52] *Ibid.*

[53] She makes a finding that under the current international framework, a situation most certainly could arise in which a dispute between two SADC members is brought before a trade panel under the SADC protocol and another international court. This overlap of jurisdiction could occur with reference to another international court that is either dealing mainly with trade related disputes or though not specifically dealing with trade, possessing a more general jurisdiction or other specialized jurisdiction other than trade. In both instances, such court could exist within Africa or beyond Africa, having more global membership. See Pauwelyn "Going Global, Regional or Both? Dispute Settlement in the Southern African Development Community (SADC) and Overlap with the WTO and other Jurisdictions". Available at http://eprints.law.duke.edu/880/1/13_Minn_J._Global_Trade_231_(2004).pdf (accessed 08/07/09).

DSU. Since all SADC members are also WTO members and many provisions in the SADC trade protocol import WTO provisions, there is a large overlap between the trade protocol and WTO agreements as applied by SADC members. Consequently, this means that many trade disputes between SADC members can be brought to the trade dispute settlement mechanism of either SADC or the WTO.[54] Further, it must be noted that the amended SADC Treaty establishes a SADC Tribunal. Art 32 states that any dispute arising from the interpretation or application of the Treaty or the validity of Protocols which can not be settled amicably shall be referred to the Tribunal.[55] The question that arises here is whether disputes under the Trade Protocol can in addition to the trade panel system established under the Trade Protocol be decided by the SADC Tribunal. Furthermore, it should be noted that some SADC members also belong to the Southern African Customs Union (SACU) and this creates an overlap between disputes that can be decided by the SADC and SACU Tribunals respectively. It is submitted that these eventuality create a greater risk of forum shopping in that litigants may attempt to have their action tried in a particular forum where they feel they will be granted the most favourable verdict.[56]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It has been argued that the SADC Trade Protocol is seriously flawed, back-loaded with confusingly differentiated tariff reduction schedules and less clearly understood are the effects of complex and restrictive rules of origin.[57] There are huge differences in size, the role

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[54] *Ibid.*

[55] Article 32 of the Amended SADC Treaty.

[56] This eventuality is not only observed in the SADC only but in other regional systems as well. Interestingly enough is the position held by American RTAs. American RTAs provide to their parties the possibility of forum selection. The selection to forum shop is often an expression of the importance that parties give to the system of norms that may be enforced by the related dispute settlement mechanisms. See Ramli *Development and the Rule of Law in the WTO: The Case for Developing Countries and their Dispute Settlement Procedures* (2008) 63. While some commentators have been critical of forum shopping, some have seen it as a legitimate manifestation of a party's autonomy that contributes to greater utilization of the judicial systems. For further reading see Shany and Yuval *The Competing Jurisdictions of International Courts and Tribunals* (2004) 332 and Kwak, Kyung and Marceau "Overlaps and Conflicts of Jurisdictions between the WTO and RTAs" 2003 *Canadian Yearbook of International Law* 83-152.

[57] Rules of origin are required in order to authenticate that goods trading under the SADC preferences actually are the result of economic activity in the region. Flatters submits that SADC trade negotiators initially agreed on a simple and transparent set of rules for this purpose but later chose a different path attempting to burden RoOs

of trade and factor endowments among countries in the southern African region.[58] SADC members have a high share of unskilled labour in the total labour force especially in agriculture and there are sizeable differences in the production structures among the SADC countries with primary products being the most important for most SADC members.[59] The Trade protocol "conforms to a symmetrical GATT Article XXIV and herein lies the problem".[60] It has been argued that this very symmetrical design enables the Trade Protocol to treat SADC states as equal and requires them to uniformly follow through on obligations to *inter alia*, reduce tariffs and harmonise standards and policies on trade.[61] Lewis, Robinson and Thierfelder argue that while such uniform application of a contractual liability is legally and politically correct since the members are sovereign states entering in to treaty obligations, it creates an absurdity when analyzed from an economic perspective.[62] What they suggest is that the protocol should have introduced a concept of differentiation by building temporary asymmetries in order to account for the diversity in the size and strength of the various economies of the SADC members.[63] It is submitted that that suggestion is not entirely plausible. Article 3 of the Trade protocol allows for asymmetrical tariff reductions among SADC member states where members can apply to the Committee of Ministers responsible for trade matters (CMT) for an extension of the time frame set for elimination of tariffs or a grace period if they consider that they may be adversely affected or have been so affected by

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with responsibility for a variety of goals that could be achieved better through other means. Furthermore, employing them as instruments of protection thus underminines the principal goal of the Trade Protocol. See Flatters "SADC Rules of Origin: Undermining Regional Free Trade". Available at http://qed.econ.queensu.ca/pub/faculty/flatters/writings/fs_sadc (accessed 27/11/08).

[58] Lewis, Robinson and Thierfelder "Free Trade Agreements and the SADC Economies" TMD Discussion Paper No 80. Available at http://www.cgiar.org/ifpri/divs/tmd/dp.htm (accessed 08/07/09).

[59] *Ibid.*

[60] Thomas "The SADC Protocol and the Enabling Clause: A view from South Africa" in Teunissen (ed) *Regional Integration and Multilateral Cooperation in the Global Economy* (1998) 155.

[61] *Ibid.*

[62] *Ibid.*

[63] Maasdorp also makes out similar points. He notes that the establishment of a SADC FTA differs from that of many integration schemes in that it starts from a position of significant polarisation among member states in so far as the geographic coverage of the transport network, standards of physical structure and the operational efficiency of transport modes are concerned. See Maasdorp "Regional Trade and Food Security in SADC". Available at www.sciencedirect.com (accessed 22/09/08).

the removal of tariffs and NTBs. In addition, different tariff lines may be applied within the agreed time frame for different products in this process.[64]

Several questions have also been asked concerning SADC's efforts at economic integration. For example:

- What is the trade potential expected from the SADC FTA given the economic structure disparities existing among its members? ; and
- Whether it is feasible to expand intra-SADC trade given the present SADC economies' structures and level of development.[65]

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Chauvin and Gauler submit that given the fact that SADC countries have concentrated and similar comparative advantages, room for further trade within SADC is limited.[66] Furthermore, it has been argued that members lack the commitment that hinders the realization of the objectives and plans of SADC. For instance, it has been said that the conduct of Zimbabwe's and Angola's governments does not demonstrate a commitment to SADC's agenda: the members' slow implementation of the trade protocol and their participation in conflicting trade and regional economic integration schemes raise

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[64] The same point is made by in Hansohm and Shilimela. In order to make provision for differentials in development across the region, member states agreed to follow the principle of asymmetry, whereby more developed members liberalise faster than underdeveloped members. In the light of this, an arrangement has been reached so that South Africa, the most advanced state in the region, undertakes a faster tariff phase down, while other member states are to offer tariff reductions to South Africa at a slower rate than what they offer among themselves. See Hansohm and Shilimela "Progress in Economic Integration within SADC" 2006 *Monitoring Regional Integration in Southern Africa Yearbook* 6.

[65] Chauvin and Gaulier "Regional Trade Integration in Southern Africa" Working Paper No 2002-12. Available at http://www.cepii.fr/anglaisgraph/work-pa/pdf/2002/wp02-R.pdf (accessed 22/09/08).

[66] Maiketso and Sekolokwane's study reviews the progress made so far by SADC member states in the trade liberalization process. They identify constraints that individual member states might be experiencing in the elimination of custom duties and non tariff barriers. However, their overall assessment should be treated as indicative rather than conclusive as the data used has gaps in terms of unavailability of some countries' trade figures. Regardless, they came to the preliminary conclusion that the growth in intra-SADC trade has generally improved and that the implementation of the trade protocol partly accounts for such an improvement. See Maiketso and Sekolokwane "Country-Use Review of the Implementation of the SADC Trade Protocol" in Kaunda (ed) *Proceedings of the 2006 FOPRISA Conference,* Botswana Institute for Development Policy Analysis 2007. See further Hansohm and Shilimela "Progress in Economic Integration within SADC" 2006 *Monitoring Regional Integration in Southern Africa Yearbook.* Similar outcomes can be found in Oosthuizen "The Future of the Southern African Development Community" 2006/7 *SA Yearbook of International Affairs* 92.

commitment issues as does their failure to transform their SADC obligations into national plans and strengthen the Secretariat.[67]

> "What explains this lack of commitment, a characteristic that seems to vary over time and among individual members? Can the reason lie in the ruling national and regional elites, whose true interests do not lie in pursuing SADC's objectives and plans, but who understand the importance of the politics of appearances? Or the clinging-on to outdated notions of sovereign statehood by regimes that-perhaps- equate the exercise of national sovereign powers in multilateral bodies with the transfer of such powers to an independent supra-national decision-making body? Or an inability, due to institutional incapacity, to handle or prioritise certain objectives among the plethora of national, regional, continental, global and other initiatives? (This in turn raises a series of other related questions: to which other such initiatives are the members more effectively committed? Were they more committed to SADC in the past? What is the significance of this?) Or do the members distrust one another too much to work together as envisioned? As another option, are there 'structural' reasons that make the necessary cooperation among them improbable? Above all, is SADC's poor performance the cause and effect of the lack of commitment, or both?"[68]

Therefore, it is evident that SADC functionaries and observers will differ on what the organization can realistically achieve or on how high the bar of success should be set.[69] It can also be noted that the Protocol fails to recognize the position of least developed countries.

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There are at least six or seven least developed countries in the SADC region but the Protocol does not deal with this and treats all countries alike.[70] This is a stark contrast to the Uruguay Agreements which make allowances for least developed countries. The Protocol also fails to recognize that although member states have agreed to tariff reductions within the WTO and are appropriately reducing them, tariffs are not the main issue within SADC.[71] The main issues are the need for increased investment, non-tariff barriers and the need for asymmetry in members' trade relationships.[72]

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[67] Oosthuizen "The Future of the Southern African Development Community" 2006/7 *Southern African Yearbook of International Affairs* 95.
[68] *Ibid.*
[69] *Ibid.*
[70] Of the 48 least developed countries identified by the United Nations, 33 are in Africa. See Thomas "Regional Cooperation for Trade Development: The SADC Trade Protocol" in Balch and Caffey (eds) *Regional Cooperation: The Role of Parliament in SADC Today* (1997) 15.
[71] *Ibid.*
[72] *Ibid.*

6.4 Compatibility with WTO law and Policy

Article XXIV of the GATT provides that for a FTA to be consistent with WTO rules:

- Duties and ORCs should be eliminated on substantially all trade in products originating between members (the internal requirement- Article XXIV: 8(b));
- Duties and ORCs maintained in each member state and applicable at the formation of such FTA to the trade of parties not members to such agreement shall not be higher or more restrictive than the corresponding duties and ORCs existing in the same constituent territories prior to the formation of the FTA (the external requirement- Article XXIV: 5(b));
- That the FTA shall be promptly notified to other contracting parties (XXIV: 7).

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The Trade Protocol adopted by SADC in August 1996 sets out the basis for a regional trade agreement. According to this protocol members have committed to:

- the transformation of SADC into a Free Trade Area by 2008;
- The elimination of all tariffs and non-tariff barriers to trade in accordance with Article XXIV: 8(b) of the GATT; and
- The elimination of import duties, export duties, quantitative import restrictions and quantitative restrictions (Article 3-8) in compliance with the definition of a FTA as provided for by GATT Article XXIV:8 (b).

6.4.1 Tariff phase out between members in accordance with the internal requirement - Article XXIV: 8(b)

The SADC tariff phase down started in 2000 and therefore it is important to assess the impact that such liberalization or its lack thereof, perhaps due to lack of implementation, has had on intra-regional trade. SADC member states identified four categories of trade tariffs:

- *Category A: immediate liberalisation.* Tariffs on these products will be reduced to zero in the first year of implementation.
- *Category B: gradual liberalisation.* Tariffs on these goods will be reduced gradually to zero over an eight-year period, as these goods constitute significant sources of customs revenue.
- *Category C: sensitive products.* Tariffs on these goods are to be eliminated between 2008 and 2012. Category C is limited to a maximum of 15 per cent of each member's intra-SADC merchandise trade.
- *Category E: goods that can be exempted.* These goods are exempt under articles 9 and 10 of the protocol and their tariffs will not be touched or reduced to zero. Examples of goods that benefit from preferential treatment are firearms and ammunitions.[73]

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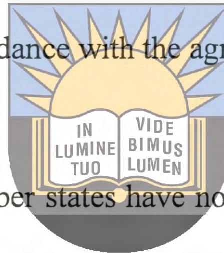
The special requirement of the Trade Protocol is that most trade should be duty free and that 85 per cent of intra-SADC trade fall into categories A and B.[74] However, it is noted that SADC countries in general have adopted a cautious approach to intra-regional trade liberalisation, wanting to continue protecting existing domestic industries and fearing losing tariff revenue.[75] Unfortunately, the slow phase-down of tariffs has given countries the space to maintain protection, especially for goods that have the greatest potential to promote cross-border trade, such as tobacco, furniture, leather, beverages, and foodstuffs.[76]

A study carried out by SADC in 2007 on the implementation of the protocol found that:

[73] Muzondga "Implementation Challenges for the SADC FTA: Tariffs and Non-Tariff Barriers" in Oesterdiekhoff (ed) *Liberalising Trade in Southern Africa: Implementation, Challenges for the 2008 SADC FTA and Beyond 6-7 August* (2008) 30.
[74] *Ibid.*
[75] *Ibid.*
[76] *Ibid.*

- When the Trade Protocol concludes in 2012, some countries will retain a wide range of permanent exclusions on imports from South Africa.
- Four member states are behind in implementing their tariff phase-down schedule and in some cases the reductions made are less than initially scheduled (Malawi, Tanzania, Zambia and Zimbabwe).
- Malawi has not implemented any tariff reductions apart from two (one in 2001 and one in 2004).
- Mozambique and Tanzania approved their tariff phase-down programmes, but have not yet implemented them in accordance with the agreed timetable.[77]



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The study clearly showed that some member states have not implemented the tariff offers as planned.[78] Although member states gazetted their tariff phase-down schedules, they delayed implementation due to various reasons. Apart from Mauritius and Zimbabwe who updated their tariff phase-down schedules for a small number of products, most member states have not revised their tariff offers for sensitive products.[79] SADC reports that currently only Malawi is behind in its tariff phase-down schedule. The study also revealed that after some member states unilaterally reduced tariffs, several MFN rates are now lower than SADC-applied rates.[80] Furthermore, countries belonging to other RTAs have implemented tariffs on SADC imports, regardless of commitments made under the SADC Trade Protocol. For

[77] As cited in Muzondga "Implementation Challenges for the SADC FTA: Tariffs and Non-Tariff Barriers" in Oesterdiekhoff (ed) *Liberalising Trade in Southern Africa: Implementation, Challenges for the 2008 SADC FTA and Beyond 6-7 August* (2008) 30.

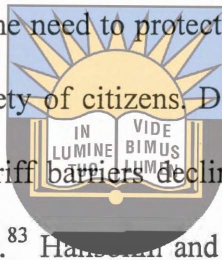
[78] *Ibid.* A similar study carried out by Kaleba and Tsedu also came to the same conclusions. See Kaleba and Tsedu "Implementation of the SADC Trade Protocol and the Intra-SADC Trade Performance" South African Development Research Network (2008) iv.

[79] Muzondga "Implementation Challenges for the SADC FTA: Tariffs and Non-Tariff Barriers" in Oesterdiekhoff (ed) *Liberalising Trade in Southern Africa: Implementation, Challenges for the 2008 SADC FTA and Beyond 6-7 August* (2008) 30.

[80] *Ibid.*

example, Tanzania gave concessions to Kenya and Uganda upon joining the CU of the East African Community (EAC) and implementing the common external tariff (CET).[81]

Trade liberalisation by SADC has made the flow of goods between countries easier and economically more rewarding, but Non-Tariff Barriers (NTBs) continue to be a concern. NTBs are defined as all measures that restrict international trade excluding customs duties/tariffs. These include government legislation, regulations, requirements, policies, conditions, restrictions and prohibitions.[82] Reasons for imposing non-tariff barriers vary from country to country, but often range from the need to protect domestic industries from foreign competition to the need to ensure the safety of citizens. Despite their widespread use, they could be perceived to be increasing as tariff barriers decline, which raises a concern given that they have an adverse impact on trade.[83] Hansohm and Shilimela argue that the outlook for NTBs is gloomy. They contend that during the process of trade liberalisation and tariff reform in the region, NTBs have become less identifiable, more arbitrary, qualitative and non-transparent.[84] NTBs include RoOs, which in SADC are overly complex and contain many restrictions. They discourage intra-regional trade by undermining smooth trade facilitation and restricting firms' flexibility to source those inputs needed to be internationally competitive. Complicated and restrictive RoOs increase administrative costs and make it



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[81] *Ibid.*

[82]Other NTBs that impede trade in the region include: communication problems; transport problems; lack of market information; services barriers such as financial, electricity, technical support; and standards and certification or technical restrictions. Transit costs and delays are significant, particularly for landlocked member countries. And some member states even impose stringent visa conditions on nationals from other SADC member states. See Kalenga "Implementation of the SADC Trade Protocol: A Preliminary Review" 2004 *Monitoring Regional Integration in Southern Africa Yearbook.*

[83] Maiketso and Sekolokwane "Country-Use Review of the Implementation of the SADC Trade Protocol" in Kaunda (ed) *Proceedings of the 2006 FOPRISA Conference,* Botswana Institute for Development Policy Analysis 2007.

[84] Hansohm and Shilimela "Progress in Economic Integration within SADC" 2006 *Monitoring Regional Integration in Southern Africa Yearbook* 2 10.

difficult for exporters to take advantage of SADC preferences. As such, they constitute a serious obstacle to the liberalisation of intra-regional trade.[85]

SADC's commitment to eliminate non-tariff barriers is reflected in Articles 6, 7 and 8 of the Trade Protocol. The Trade Protocol recognises the role that NTBs can play in impeding intra-regional trade. Article 6 of the Protocol commits the member states to "adopt policies and implement measures to eliminate all existing forms of NTBs" and "refrain from imposing any new NTBs". However, besides the commitments in the Trade Protocol, the SADC member states have not put in place any modalities to kick start the process of implementing the elimination (or reduction) of NTBs.[86] It should also be noted that the Protocol subjects Article 7 and 8 dealing with quantitative import and export restrictions to a general exceptions clause. Although the general exceptions clause contains a provision which aims to prevent protectionism, that is, policies aimed at protecting domestic markets from competition, it is submitted that the fact that it provides for the application of these quantitative restrictions between member states at all could be interpreted as a violation of Article XXIV: 8(b) because it is contrary to the definition of a free-trade area in Article XXIV (8) (b).

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The Understanding on the Interpretation of Article XXIV of GATT 1994 sets a time frame of 10 years for the implementation of a free-trade area and also makes allowances for the extension of this period where Member States provide the Council for Trade in Goods with a sufficient explanation for the need of a longer period.[87] Given the fact that SADC Member States have chosen to implement the free-trade area within 8 rather than 10 years, the time

[85] Khandelwal "COMESA and SADC: Prospects and Challenges for Regional Integration" 2004 *IMF Working Paper* 42.
[86] *Ibid.*
[87] Para 3 of the Understanding on the Interpretation of Article XXIV of the GATT.

period wherein Member States can eliminate tariffs and non-tariff barriers on substantially all intra-SADC trade is an important one, especially given the decision by these States to reduce the initial period from 10 to 8 years.[88] It is submitted that considering the differences in developmental status of Member States, the decreased period for elimination of tariffs and non-tariff barriers is rather peculiar especially considering that the least-developed economies would need a longer period to adjust to free-trade within the SADC. It is provided by Article 3 that the elimination of barriers shall be achieved within a time frame of eight years from entry into force of the Trade Protocol but member states who feel they may be or have been adversely affected by the removal of tariffs and non tariff barriers may be granted a grace period to afford them additional time for the elimination of tariffs. It is submitted that this may lead to a violation of Article XXIV as it creates an overlap with the GATT's mandate to set a time frame for the elimination of tariffs in that the Understanding on the Interpretation of Article XXIV provides for a 10 year phase-down period of tariffs whereas the SADC protocol having originally provided for 8 years also confers the powers to authorize an extension of this period.[89]

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An assessment of the tariff phase-down schedule for intra-SADC trade reveals the failure by the member states to successfully liberalise "substantially all trade", that is 85% of intra-SADC trade (measured by trade values). This eventuality is a violation of Article XXIV: 8(b) of the GATT.

[88] Grimett Protectionism and Compliance with GATT Article XXIV in Selected Regional Trade Agreements (LLM Thesis, Rhodes University, 1999) 222.
[89] It can be noted that para 3 of the Understanding on the Interpretation of Article XXIV also provides for the extension of the ten year period on exceptional cases provided a full explanation to the Council for Trade in Goods is given.

6.4.2 Compliance with the external requirement - Article XXIV: 5 (b) of the GATT

It appears that Member States have complied with the Article XXIV (5) (b) provision which requires that customs duties and regulations not be higher or more restrictive than the corresponding duties and regulations which existed in the same territories before the formation of the free-trade area.[90] Not only have Member States undertaken not to raise import duties beyond those which existed prior to the entry into force of the Trade Protocol, but they have also undertaken to grant no less favourable treatment to third states than they give to Member States in circumstances where export duties and quantitative export restrictions are applied.[91] These undertakings are in keeping with the Article XXIV (5) (b) provision and ensures third parties are not subjected to any less favourable treatment than member states.

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A provision which could cause some concern and could provide Member States with an opportunity to protect their economies is Article 4 (5) of the SADC Trade Protocol which provides that while Member States cannot raise import duties beyond those which exist when the Trade Protocol comes into force, they are not prevented from imposing across-the-board internal charges. It is submitted that due to the fact that no limits or qualifying provisions have been given for the application of this provision, it would be difficult to evaluate whether these have been raised above their existing levels.

6.4.3 Prompt Notification in terms of Article XXIV: 7 of the GATT

WTO members are obliged to notify the RTAs in which they participate. Pursuant to the August 2002 decision of the 16th Meeting of the SADC Committee of Ministers of Trade

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[90] Article XXIV: 5(b) of the GATT.
[91] Articles 4 and 5 of the SADC Trade Protocol.

(CMT) to notify the SADC FTA to the WTO under Article XXIV of the GATT, a factual presentation on the SADC Protocol on Trade was prepared by the SADC Secretariat and was considered during a meeting of the WTO Committee on Regional Trade Agreements (CRTA) which met on the 14-16 May 2007 in Geneva.[92] It is at this meeting that consideration of the SADC Protocol was declared to be duly finalized and not subject to future deliberation by the Committee therefore completing the process of notification of the SADC FTA in terms of the WTO's Article XXIV.[93] Following the *Bananas* 1 case it can arguably be submitted that the mere fact that a RTA is notified to the WTO does not automatically render the RTA WTO-compatible.[94]

6.5 Conclusion

Reviews and studies carried out on the progress made in the implementation of the SADC Trade Protocol have cast some doubts on the success of its implementation. They have revealed some sluggishness on the part of some member states and in some cases complete failure to implement the Protocol.[95] This clearly shows that the protocol as a sound policy instrument aimed at eliminating tariffs among members has not fully achieved its objectives. There has been a slow phase-down of tariffs which potentially affords SADC countries the space to maintain protection which essentially could be attributed to the gaps in the GATT's regulatory framework for the regulation of regional trade agreements.

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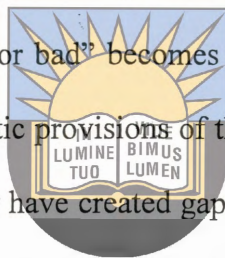
[92] The Official SADC Trade, Industry and Investment Review 11th ed (2007-2008) 36. See also Report by the WTO Secretariat: Factual Presentation on the Protocol on Trade in the Southern African Development Community WT/REG 176/4 12 March 2007. Available at http://rtais.wto.org/rtadocs/45/FactualDocs/English/WT-Reg176-4e.doc#FP3 (accessed 05/07/09).
[93] For a note on the questions fielded by various delegations on details of export duties and export restrictions currently applied by SADC members see WTO document WT/REG176/6 3 July 2007. Available at http://rtais.wto.org/rtadocs/45/FactualDocs/English/WT-Reg176-4e.doc#FP3 (accessed 05/07/09).
[94] The same point was made in Mathis that notification to the GATT alone is not sufficient to immunize regional preferences from later challenges. Thus although regional formations may be self declaratory in nature they are not necessarily self qualified upon declaration. See Mathis *Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement* (2002) 87-88.
[95] See Muzondga "Implementation Challenges for the SADC FTA: Tariffs and Non-Tariff Barriers" in Oesterdiekhoff (ed) *Liberalising Trade in Southern Africa: Implementation, Challenges for the 2008 SADC FTA and Beyond 6-7 August* (2008); Kaleba and Tsedu "Implementation of the SADC Trade Protocol and the Intra-SADC Trade Performance" South African Development Research Network (2008) 23.

Chapter 7

CONCLUSIONS AND RECOMMENDATIONS

7.1 Conclusions

Regionalism is a much debated topic among trade economists, analysts and scholars but precise and irrefutable answers have not emerged from these deliberations. As the ability of the World Trade Organization (WTO) to maintain the unsteady yet distinct momentum towards multilateral trade liberalization is put into question, the subject of whether Regional Trade Agreements (RTAs) are for "good or bad" becomes even more pressing.[1] This study has dealt in great detail with the problematic provisions of the General Agreement on Tariffs and Trade (GATT) on RTAs and how they have created gaps or loopholes that make it easier for countries to default on their obligations under the WTO.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The study begins with an introduction of the concept of regionalism and how it is strictly speaking a violation of the GATT's principle of non-discrimination.[2] The study then proceeds with a historical overview of RTAs to provide insight into the interplay between RTAs and the multilateral trade system. What the study has found is that RTAs have a long history.[3] In fact, for as long as countries have been trading with one another they have always discriminated against some nations in favour of others. Virtually all countries in the world are now members of at least one RTA.[4] However, the current model of RTAs seems to differ considerably from the model of RTAs which existed prior to and during the inter-war years.[5] RTAs have expanded vastly in number, scope, coverage and are capable in most instances of

[1] Winters "Regionalism vs Multilateralism" in Baldwin, Cohen, Sapir and Venables (eds) *Market Integration, Regionalism and the Global Economy* (1999) 7.
[2] See Chapters 1 and 2.
[3] See chapter 3 paras 3.1, 3.2 and table 1.2.
[4] Crawford and Fiorentino "The Changing Landscape of Trade Agreements" Discussion Paper No 8: World Trading Organization. Geneva, Switzerland, (2005). Available at http://www.wto.org (accessed 18/04/08).
[5] *Ibid.*

assisting least developed, developing and transition economies in integrating into the international trading community.[6] What has been shown is that their proliferation is motivated by diverse political and/or economic factors and interests. In this sense they present a challenge to the multilateral trading system as one country's motivation for becoming party to a RTA may not be the same as that of another. At a political or foreign policy level they entail "playing favourites and risk reducing international relations to mutually destructive factionalism of the kind that was so dramatically evidenced in the 1930s".[7] From an economic point of view the question of whether RTAs are welfare improving or welfare reducing remains open ended as no general presumption can be made regarding their net impact.[8] According to Winters, one can build models that suggest either conclusion.[9]

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RTAs have the potential to place countries in conflict with WTO rules or encourage countries to abandon their WTO rights when becoming parties to RTAs.[10] This may result from the RTA replacing WTO rules with rules negotiated between the RTA partners, membership in overlapping agreements or, more seriously, entrenching policies that are capable of promoting trade bloc conflict.[11] Furthermore, some RTAs have been found to contain dispute settlement provisions that are inconsistent with those of the WTO.[12] This has not only been observed in the SADC but in other regional systems as well, for example, American RTAs provide to their parties the possibility of forum selection.[13] The option to forum shop is often

[6] Bhala and Kennedy *World Trade Law* (1998) 160.
[7] Trebilcork and Howse *The Regulation of International Trade* (1999) 130.
[8] The net impact of a RTA depends on specific circumstances. See Viner "The Customs Union Issue" in Bhagwati, Krishna and Panagariya (eds) *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreements* (1999) 105.
[9] Winters 7.
[10] See discussion in chapter 2 para 2.6.
[11] Ostry *The Post-Cold War System: Who's on First?* (1997) 204.
[12] See chapter 4 para 4.4 for a discussion of the conflict of overlapping laws and jurisdiction between WTO tribunals and those of RTAs.
[13] See chapter 6 para 6.3.4 for a discussion of the overlap of the SADC dispute settlement mechanism on trade and other international dispute settlement systems.

an expression of the importance that parties give to the system of norms that may be enforced by the related dispute settlement mechanisms.[14] This has serious implications for the multilateral trading system as it could build jurisprudence that conflicts with that of the WTO.

Chapter 4 largely focused on the substantive aspects of the provisions of Article XXIV. What the study uncovered is that although Article XXIV is far from perfect, in principle it imposes a very serious discipline.[15] However, the current provisions of Article XXIV as they stand continue to provide plenty of opportunity for harmful WTO-consistent policies and more for WTO-inconsistent policies as well.[16] It is submitted that this eventuality seems to be fuelled by the fact that in most cases consensus can not be reached on whether RTAs comply with WTO provisions. Even with the Committee on Regional Trade Agreements in place to review RTA consistency, compliance with GATT rules has still proved fruitless. Therefore it appears that on this point the problem lies with the consensus rule.[17] Case law also seems to be able to go only so far in offering some insight into the interpretation of Article XXIV. Any developments that can exert more precise standards for RTAs are bound to influence the design of later agreements and the manner in which they are declared to the WTO.[18] It therefore remains to be seen how the Doha Development Agenda will proceed on the subject of RTAs.

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In an effort to improve and strengthen the legal disciplines of Article XXIV, the Uruguay Round Understanding on the Interpretation of Article XXIV has addressed a number of issues surrounding the legal requirements for the formation of customs unions and free trade areas.

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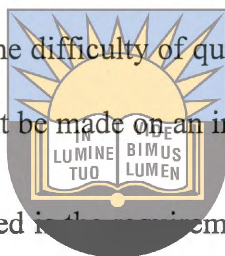
[14] Ramli *Development and the Rule of law in the WTO: The Case for Developing Countries and their Dispute Settlement Procedures* (2008) 63.
[15] Hoekman and Kostecki *The Political Economy of the World Trading System: The WTO and Beyond* (2001) 356.
[16] *Ibid.*
[17] *Ibid.*
[18] Mathis *Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement* (2002) 295.

For instance, the Understanding makes it clear that free trade areas, customs unions and interim agreements leading to the formation of either customs unions or free trade areas to be sanctioned by the GATT should comply with paragraphs 5, 6, 7 and 8 of Article XXIV.[19] With regards to the requirement in Article XXIV: 5 that the general incidence of duties and other regulations of commerce applicable before should not be higher than after the formation of the RTA, the Understanding provides that this assessment should be based on weighted tariff rates and customs duties collected based on import statistics for a previous representative period.[20] In the case of regulations, duties and charges that are arguably more restrictive, the Understanding recognizes the difficulty of quantifying such duties and charges and therefore provides that such assessment be made on an individual or case-by case basis.[21]



A requirement that remains largely unsettled is the requirement of "substantially all trade" as found in paragraph 8 of Article XXIV. It is submitted that trying to uncover what the requirement entails may be possible by first accepting what it has been found not to require. For instance, it seems that proposals that coverage of the "substantially all trade" requirement is deemed to be achieved when the volume of liberalized trade reaches 80% or 90% of total trade are unsound. This is because an interpretation of this kind would allow certain sectors to be totally excluded even if total liberalization reaches these levels. A quantitative interpretation could also mean that trade barriers left intact after the formation of a RTA could be so high that 100% of all observable trade could in fact be liberalized "but no account would be taken of trade that did not occur because of prohibitively high trade barriers that were not dismantled.[22] However, it seems that members of the WTO have compromised on accepting that the "substantially all trade" requirement contains both qualitative and

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[19] The Understanding on the Interpretation of Article XXIV of the GATT para 1.
[20] The Understanding para 2.
[21] *Ibid.*
[22] Bhala and Kennedy 167.

quantitative elements.[23] It is submitted that even with this compromise it still seems likely that another problem could arise when trying to strike a balance between the proportions of actual trade covered in both qualitative and quantitative terms in order to determine compliance with the requirement. From an analysis of the case law in chapter 5, the *exceptions list* is deemed to be exhaustive and shall be interpreted as to allow the listed Articles to remain applicable without any detraction from it.[24]

The meaning of "other regulations of commerce" in paragraph 5 of Article XXIV appears to have the same meaning as "other restrictive regulations of commerce" in Paragraph 8. The "other regulations of commerce" phrase in paragraph 8(a) (ii) seems to have a broader scope than the "other restrictive regulations of commerce" in 8(a) (i) and 8(b) and therefore encompasses not only border measures, but a[illegible] measures.[25] The issue of whether Rules of Origin are a restriction to trade in the sense that they are encompassed by the "other regulations of commerce" concept also remains largely unresolved.[26] A consideration of rules of origin as "other regulations of commerce" would make it difficult to compare whether the general incidence of duties before and after the enlargement of an existing RTA or its replacement by a new one have been increased as in terms of Article XXIV: 5(a). The WTO has yet to make to make a ruling on this point.

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An analysis of the internal and external trade policy of the Southern African Development Community (SADC) in chapter 6 has revealed that there exists some contradiction of the trade bloc as envisioned by the GATT. Failure by some members of SADC to fully implement the SADC Trade Protocol results in a violation of the provisions of Article XXIV

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[23] See *Turkey-Restrictions on Imports of Textile and Clothing Products* WT/DS34/AB/R 22 October 1999 para 48.
[24] *Ibid.*
[25] See the discussion in chapter 4 para 4.3.1.2.
[26] See the discussion in chapter 4 para 4.3.2.4.

for the bloc to be compliant with the provisions of the GATT on RTAs. Consequently, this implies that regionalism and multilateralism will continue to evolve in parallel: multilateral rules will often be bypassed and protections built into regional designs.[27] It is therefore submitted that SADC should have been notified under the Enabling Clause[28] in terms of which parties can agree to liberalize only a certain percentage of their trade. By notifying SADC under Article XXIV of the GATT, then the SADC RTA would have to abide by all its provisions.

7.2 Reform and Recommendations

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> "If we do not get what we want from the negotiating agenda, why should we worry? We have our own RTAs and that is where the action is".[29]

Comments like these from WTO members justify the call for the provisions of Article XXIV to be strengthened. Baldwin and Thorton assert that "some members of the WTO talk about multilateralism and then go back and cook spaghetti outside Geneva".[30] They note that this contradiction shows that the issue is not one of the WTO versus something else but of something that is built into each and every member of the WTO.[31] If Article XXIV can be strengthened the contributions that RTAs could make in global trade could be substantial.[32] The different ways in the WTO can achieve that objective are discussed below.

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[27] Kurz, Otter and Povel "SADC Trade Integration-The Effort of Trade Facilitation on Sectoral Trade: A Qualitative Analysis" 2006 *Monitoring Regional Integration in Southern Africa Yearbook* 56.

[28] The Enabling Clause is officially called the Decision on Preferential and more Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries of 28 November 1979 (L/4903). Available at http://www.wto.org/english/docs_e/legal_e/enabling1979_e.htm (accessed 09/08/08).

[29] Laird and Crawford "Regional Trade Agreements and the WTO". Available at http://www.nottnghamuniversity.com/economics/credit/research/papers/cp.003.pdf (accessed 02/09/08).

[30] Baldwin and Thorton *Multilateralising Regionalism: Ideas for a WTO Action Plan on Regionalism* (2009) 37.

[31] *Ibid.*

[32] Bagwell and Staiger *The Economics of the World Trading System* (2002) 33.

7.2.1 Clarification of key provisions of Article XXIV of the GATT

Controversy over Article XXIV provisions implies that countries do not know which rules to follow. The WTO can strengthen and provide precise criteria for RTA formation in order to clear the ambiguities that have permeated Article XXIV. For instance, a fixed criterion for the "substantially all trade" requirement could be adopted. By doing so, countries will have certainty as to the conditions that should be satisfied in order to fulfil the "substantially all trade" requirement. However, there are those who caution against this approach. For instance, Mathis has opined that developing a fixed criterion for the requirement could raise other problems, for example, countries maybe inclined to meet only the minimum requirement without seeking to generate higher levels of coverage.[33] It is alternatively submitted that the word "substantially" could be dropped from the requirement so that elimination of trade barriers covers all trade as opposed to part of it. The ease with which "sensitive" sectors can be excluded from liberalization suggests that a loose interpretation could be very damaging for the multilateral trading system.[34]

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7.2.2 Encouraging RTAs to incorporate GATT provisions or principles in to their agreements by reference.

To prevent the creation of rules that are in conflict with WTO rules, RTAs can be encouraged to incorporate GATT provisions by reference when negotiating their own agreements. Good examples can be found in the agreement of the North American Free Trade Area (NAFTA). Article 301 of this agreement provides that national treatment of trade in goods should be granted in accordance with Article III of the GATT and article 309 expressly refers to Article XI of the GATT which deals with import and export restrictions.[35] For practical purposes,

[33] Mathis 291.
[34] See Roessler "The Relationship between Regional Integration and the Multilateral Trade Order" in Anderson and Blackhurst (eds) *Regional Integration and the Global Trading System* (1993) 313.
[35] Serra et al "Reflections on Regionalism" *Report of the Study Group on International Trade* (1993).

this would mean that disputes arising from these provisions would require an understanding of the GATT body of precedents on article III and XI respectively.[36] Similarly, it is submitted that the WTO can discourage RTA members from adopting forum selection provisions in their agreements. Countries that enter into RTAs should always be free to take to the WTO any dispute that calls into question both RTA and WTO rules. Furthermore, it is submitted that in this eventuality RTA panels or adjudicating bodies would have to be allowed to consult the WTO or alternatively the WTO be allowed to submit an opinion on the interpretation or application of the relevant RTA provision. This would promote the development of uniform precedents for the WTO as well as RTAs.

7.2.3 Improvement of monitoring and enforcement mechanisms

Compliance with Article XXIV provisions should be viewed as a process.[37] However, it seems that steps in this direction have already been taken with the establishment of the Committee on Regional Trade Agreements (CRTA) which has the mandate to ensure and review RTA consistency with GATT rules. For several reasons, advanced in the course of this research, it seems that owing to members' divergent understanding of the criteria contained in the rules themselves, the examination mechanism has been and will largely remain ineffective. Serra and others have suggested that working parties should be organized before RTA negotiations begin as WTO input may be helpful in shaping an agreement that is compatible with WTO rules.[38] Furthermore, WTO involvement should continue well after the creation of a RTA. It is submitted that taking cognizance of the fact that RTAs are proliferating at an unprecedented rate, regulation of this sought may be impossible. Owing to resource and financial constraints, an undertaking of this magnitude may not bring the desired results. What is suggested is that the existing WTO regulatory and enforcement mechanisms

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[36] *Ibid.*
[37] *Ibid.*
[38] *Ibid.*

be strengthened. For instance, the already existing Transparency Mechanism (TM) could be deepened, for instance, by expanding on the range of data provided to the WTO by the RTA.[39] Full statistical information is required to conduct a RTA examination and should be provided for the years prior to and following the RTA's entry into force.

7.2.4 Assisting developing countries with regionalism challenges

Developing countries have always been part of the global trade policy development process although they have not played a significant role in shaping or establishing international trade policy. Because of this fact, fundamental interests of developing countries have not always received substantial consideration in the GATT negotiation process and outcome.[40] It is submitted that equally developing countries are now also facing similar challenges in RTA negotiations as they had encountered in multilateral trade negotiations. Regional trade agreements are difficult to construct and negotiate. Financial and resource constraints make this task even more difficult. Developing countries may find it hard to fully evaluate policies demanded in a RTA especially by developing country partners which may place them in weak negotiating positions.[41] Developing precise criteria for WTO requirements on RTAs would assist developing countries decide which negotiating positions they can reasonably and legitimately adopt when entering into RTAs.[42]

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[39] The Transparency Mechanism aims at making RTAS easier to examine for all contracting parties, mainly by requiring members to a RTA to give early announcement about entering into RTA formation or negotiations, and requiring RTA members to provide the WTO with the information needed for a proper examination. See the World Trade Organization "Transparency Mechanism for Regional Trade Agreements" Decision of 14 December 2006, WT/L/671 available at http://www.wto.org/english/tratop_e/dda_e/dda_e.htm (accessed 05/05/09).
[40] Crump and Maswood (eds) *Developing Countries and the Global Trade Negotiations* (2007) 1-2.
[41] *Ibid.*
[42] Scollay "Substantially all Trade: Which definitions are fulfilled in Practice? An Empirical Investigation" *A Report to the Commonwealth Secretariat* (2005) 9.

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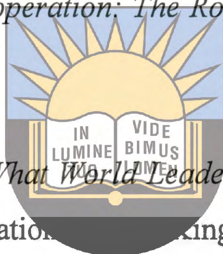

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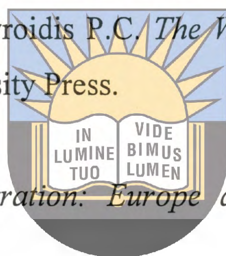

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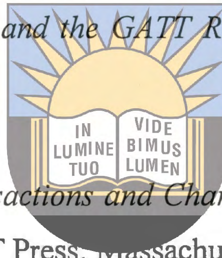

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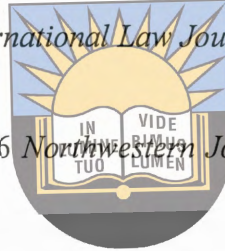
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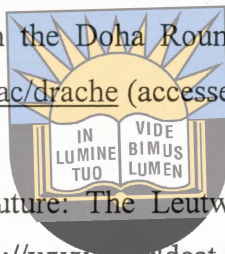

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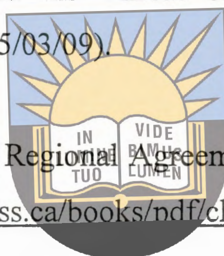

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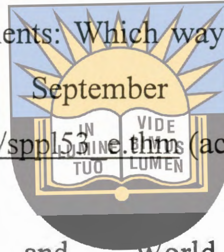

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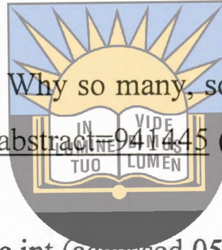

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