



DEPARTMENT OF LAW

School of Business, Economics and Law

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**A Legal and Political View on
Regional Trade Agreements in the
GATT/WTO**

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GATT Article XXIV

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Master Thesis

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Abstract

The issue of globalization and world trade liberalization has been vigorously debated over the past few years, culminating in the WTO-riots in Seattle 1999. Since then, various NGOs have claimed that WTO and its regulatory framework; GATT, is not a sincere attempt to bring prosperity to all members of WTO, i.e. including those in the third world. In contrast, the NGOs claims that WTO is just another “rich mans club” with the one and only intention to further exploit the weakest countries for the sake of expanding economical profits.

It is undisputed that the foundation and cornerstone of GATT/WTO, i.e. the MFN-principle is a rule of non-discrimination and justice; however, it is important to gain knowledge of how the MFN-principle is applied by the competent authorities within the WTO system to secure a fair and just view of the underlying intentions of the WTO. The rule of thumb saying that “the exception defines the rule” is striking concerning this matter, especially since the exception (Article XXIV GATT 1994) in this case has been used and abused over and over again, to the degree that the rule, i.e. MFN, runs the risk of being diluted to the point where it no longer qualifies as a general rule. This thesis treats the main exception from the rule of MFN, i.e. Article XXIV GATT 1994 because this is the exception that defines the MFN-principle and as such being extremely important.

This thesis covers the legal as well as the political and economical aspects of the XXIV dilemma. The purpose is to reveal the forces that have an impact on this subject, be it the lobbyists acting in Washington or Geneva, the rapidly changing global trade flows, economical incitements or the Appellate Body decisions regarding this matter. The main focus will however be on the legal aspects, including the ever so important issue of drafting history to render possible a deep understanding of this dilemma. This thesis is supposed to cover all the vital areas concerning Article XXIV, so as to provide an overall understanding of the subject, however without neglecting the highly important deep penetration of the legal aspects of the problem. The reason for an overall approach is that the subject matter is extremely complex, especially the legal aspects, and that this thesis may fill a void, i.e. to provide the reader with an easy to grasp, but nevertheless deep, understanding of the XXIV dilemma.

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List of Abbreviations

| | |
|----------|--|
| ASEAN | Association of Southeast Asian Nations |
| CRTA | Committee on Regional Trade Agreements |
| CU | Customs Union |
| CUSFTA | Canada-US Free Trade Agreement |
| DSU | Dispute Settlement Understanding |
| DSU | Dispute Settlement Understanding |
| EC | European Communities |
| EFTA | European Free Trade Agreement |
| FTA | Free Trade Agreement |
| GATT | General Agreement on Tariffs and Trade |
| GSP | Generalized System of Preferences |
| IMF | International Monetary Fund |
| ITO | International Trade Organization |
| MERCOSUR | Mercado Común del sur (Southern Common Market) |
| MTS | Multilateral Trading System |
| NAFTA | North American Free Trade Agreement |
| NGO | Non Governmental Organizations |
| ORC | Other Regulations of Commerce |
| ORRC | Other Restrictive Regulations of Commerce |
| RoO | Rules of Origin |
| SAT | Substantially All the Trade |
| TBT/SPS | Technical Barriers to Trade/Sanitary and Phytosanitary |
| TM | Transparency Mechanism |
| UNCTAD | United Nations Conference on Trade and Development |
| VCLT | Vienna Convention on the Law of the Treaties |
| WTO | World Trade Organization |

SECTION I

INTRODUCTION

1 Introduction to topic

My interest in International law in general and the legislature concerning the World Trade Organization (WTO) and the General Agreement on Tariffs and Trade (GATT) law in particular is mainly based on my interest in political and fair trade issues in combination with my interest in law and how law can be a tool to accomplish good. The multilateral trading system of WTO/GATT addressed in this thesis has attracted my interest due to its inherent possibility of helping third world countries help themselves. In other words I believe in a multi faceted solution to the many challenges the world is currently facing, such as environmental issues, widespread injustice and the ever so complicated issue of the combination of those.

This is why I have chosen to analyze Article XXIV GATT 1994 in this thesis, since it has such extensive and hard to grasp, effects on the world community. Furthermore, to those who believe that multilateral trade liberalization is the solution to many of the problems the world are facing today, Article XXIV is of paramount importance. This is because XXIV is threatening to dismantle the core principle of GATT, namely the Most Favored Nation Principle (MFN). Article XXIV being an exception to the MFN principle allows discrimination instead of combating it. Nevertheless, for several reasons, the opinions differ on whether the Regional Trade Agreements (RTA) proliferation which is currently in progress is for good or for bad.

2 Purpose

The purpose of this thesis is to study the pros and cons and the reasons behind the proliferation of RTAs. I will penetrate the political side of this issue as well as the legal, and finally I will try to determine its combined effect on world trade liberalization. I will investigate what forces that have an impact on this issue, be it political, economical or legal. I will in particular penetrate the legal arena and how, legal tools can be used to solve the RTA/WTO dilemma. An all embracing purpose of this thesis is to describe the subject matter in a way that renders it comprehensible.

The core problems of the RTA/WTO dilemma will be identified as being; (1) The incorporation of Free Trade Areas (FTAs) in Article XXIV as an entity afforded MFN deviation in addition to Customs Unions (CUs), this will be shown as being a relatively significant deviation from the original draft of Article XXIV. (2) The problem of the considerable differences in complexity between, on the one hand FTAs being a shallowly integrated entity and on the other hand CUs being a deeply integrated entity. This major difference leads to complications, namely the relatively uncomplicated construction and formation of FTAs compared to CUs that has compelled nations worldwide to engage in FTAs instead of CUs, which, in turn, has resulted in a never before seen FTA proliferation that threatens to damage the Multilateral Trading System (MTS). In other words, a nation that wishes to enjoy the benefit of MFN exception has two choices, the complicated formation of a CU or the relatively simple formation of a FTA, the path of least resistance provides the obvious answer, i.e. the formation of a FTA. This has, according to this author, undermined the original purpose of RTAs as being a construction which would create closer relationships between nations and/or creation of non discriminatory trade preferences benefiting all WTO members.¹ (3) The legal complications regarding the RTA/WTO dilemma, i.e. cursory readings of Article XXIV that has contributed to the RTA proliferation within WTO, weaknesses in certain provisions in Article XXIV, such as “Substantially All Trade” (SAT) and “Other Restrictive Regulations of Commerce” (ORRC), the lack of functioning control mechanisms and the growing complexity of overlapping “rules of origin” (RoO) which is the effect of FTA proliferation.

¹ *The drafting history of Article XXIV explains why a CU can accommodate non-discriminatory trade preference which a FTA cannot, see 10.1*

I intend to demonstrate how the existing provisions of XXIV can be interpreted as to support multilateralism instead of deteriorating it, and that this interpretation has a well established foundation in the drafting history and purpose of the GATT and the Vienna Convention on the Law of Treaties (VCLT) as well as in the ordinary meaning of the words of Article XXIV of GATT 1994. I will also describe the more cursory interpretations of that same article and try to sort out the different interests which may benefit from such interpretations.

My intention is to provide a political as well as a historical background to the subject matter, for the purpose of establishing a solid foundation for the reader so that the more detailed and complex, legal side of this issue can be comprehended. The method of gathering information for this thesis is basically the old fashioned method of searching library databases, WTO databases, EC databases etc. Moreover, a common and very functional method is to inspect other author's references to find more information about a specific subject. Furthermore, case law has been of great importance for understanding the applicability of Article XXIV. Nonetheless, case law concerning RTAs is scarce, the 1999 Turkey-Textiles Appellate Body decision has proven to be very important when interpreting the many vague provisions of Article XXIV.

As in most writing or reading of legal texts, the overall understanding of the subject is vital to be able to comprehend the matter, and such understanding can only be gained in one way, reading and thinking and reading again. It is a time consuming method, but nevertheless, well proven.

3 Limitations

This thesis covers Article XXIV GATT 1994, trade in goods, this means that the similar provisions found in the General Agreement on Trade in Services (GATS) Article V, The Enabling Clause and the Generalized System of Preferences (GSP) falls outside of the scope of this thesis.

Although economics are not the major subject of this thesis it can not be entirely left out of the scope. As a consequence, economic forces having an impact on this subject matter are included in the political section for the purpose of providing a deeper understanding of the subject. However, it shall be noticed that the economic aspects brought up in this thesis is not intended to be exhaustive.

The subject matter of RoO is extremely complex and an exhaustive analysis would require space that is not available in this thesis. However, the subject cannot be left out of the discussion in the context of RTAs and especially FTAs. As a consequence, the analysis of RoOs will be brief and shall not be regarded as exhaustive.

The functions of the Committee on Regional Trade Agreements (CRTA) and the Transparency Mechanism (TM) are highly relevant to the XXIV dilemma; however, the CRTA/TM will only be briefly covered due to lack of space.

4 Disposition

This thesis consists of 19 chapters divided into four sections. The purpose of dividing it into sections is primarily to clarify the switch from one viewpoint to another, i.e. introduction (1), the political/economical arena (2), the legal arena (3), and finally the conclusion (4). I intend to start with the politics/economics around this matter, since these are two of the major forces in multilateral development. Moreover, the political/economical arena functions not only as the creator of the legal arena, it also has a significant impact on the applicability of the legislation it has created. Consequently, politicians and corporate leaders have great but subtle influences on the legal arena. Subtle in the aspect that it is often difficult to decipher the multitude of different forces influencing the decisions taken, but, perhaps more importantly, those decisions that are *not* taken, i.e. the lack of resolve, by Panels and the Appellate Body, or the obvious absence of corrective means regarding this issue.

Consequently, the political and economical aspects on the subject matter forms the foundation of the legal arena, and acts as one of the major forces behind the scenes when applying the legislation. Therefore it is of great importance to comprehend the political arena before penetrating the legal arena, hence, it is politics that forms the legal arena and for this reason this is the logical order in which to attack this issue.

When an understanding of the politics and economics has been provided I will shift to the technicalities of the legal arena, as to provide an understanding of why Article XXIV was drafted the way it is. Furthermore, I will carry out a deep analysis of all the vital provisions of Article XXIV, analyze relevant case law and examine the CRTA and the poorly functioning control mechanisms created to monitor the observance of GATT Article XXIV.

Finally I will conclude the findings of this thesis in an effort to provide the reader with an overall understanding of the complicated nature of the WTO/RTA dilemma.

SECTION II

THE POLITICAL/ECONOMICAL ARENA

5 Introduction

The efforts of involving the third world in world trade in the course of the WTO system have been vigorously debated recently. The strategy of helping third world countries by using mechanisms of market economy has been looked upon skeptically by numerous Non Governmental Organizations (NGOs), such as Greenpeace and ATTAC. These organizations question the sincerity of the WTO efforts of creating a set of rules and regulations to boost international “fair trade”, and whether the WTO is only yet another way to justify western companies exploitation of the developing countries and their commodities such as oil, gas, diamonds etc.²

Nevertheless, today, WTO is part of our reality and the progress of creating a single world market is under way. There is great acceptance among governments that free trade is the key instrument to prevent problems such as starvation and war, particularly in the third world.³ The purpose of free trade is to generate more trade, this can be accomplished by involving new actors on the market e.g. developing countries in the third world. Pro-world traders are convinced that tearing down trade barriers such as tariffs, quantitative restrictions and Technical Barriers to Trade (TBT), will assist developing countries in taking a more active role in world trade and thereby benefit from a growing economy.⁴

When GATT was created in 1947 there were no RTAs in force. There had been RTAs in the past such as the UK-France-Cobden-Chevalier treaty of 1870, which actually applied the MFN-principle; however, the MFN-principle did not function the way it was intended to and the treaty eventually ceased due to the First World War.⁵

²<http://www.greenpeace.org>, <http://www.attac.se>

³ *Judging from the sheer number of members in the WTO*

⁴ *The main goal of the WTO is to establish a trade-barrier-free world, so that all countries can trade on equal terms*

⁵ **Whalley John**, "Recent Regional Agreements: Why So Many, So Fast, So Different and Where Are They Headed?" (September 2006). CIGI Working Paper No. 9 Available at SSRN: <http://ssrn.com/abstract=941445>, p5

Even if RTAs were not a major issue in 1947, article XXIV of the GATT treaty, was agreed upon to be used as a rule of exception, mainly upon dissolution of states such as the one including Sweden and Norway in 1905, or the later dissolution of the Czechoslovak republic in 1993.⁶ Moreover, the purpose was to encourage states to complement the GATT treaty bilaterally, with the purpose of benefiting world wide trade liberalization.⁷ Hence, some would argue that the main purpose of article XXIV has been somewhat distorted in recent years.

Today the situation is influenced by setbacks in WTO negotiations under the Doha round⁸ which has created a vacuum in the eagerly awaited progress of trade liberalization. The absence of progress multilaterally seems to have encouraged WTO members to engage in bilateral negotiations in order to gain progress. The result is a staggering increase of new RTAs. Currently, only one WTO member is not involved in any RTA, i.e. Mongolia.⁹ For many others, 90 % of their trade is preferential (RTA trade) and for others even less trade relationships rely on the MFN-Principle.¹⁰ Moreover, countries who previously have been reluctant to participation in regional agreements, such as Japan, have recently concluded several RTAs. Another large player, the US, who has been a major promoter of multilateralism during the last 40 years, has since the year 2000 entered into RTAs with Oman, Jordan, Australia, Morocco, Peru, Singapore, CAFTA (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua) and are currently negotiating with Korea, Panama, Thailand, United Arab Emirates, Columbia, Ecuador, Venezuela, Botswana, Lesotho, Namibia, South Africa and Swaziland. The EC along with China and Singapore is in similar positions. This development has actually given name to the

⁶ *The subsequent CU between the Czech and Slovak Republics is, to this day, the only one which has been acknowledged as being in full compliance with Article XXIV GATT 1994*

⁷ *See for example, Viner, Jacob, "The Customs Union Issue", 1950, p 12. Where he argues that "the Most-Favored Nation Principle [is] not a serious barrier to a customs union", meaning that a CU should actually comply with MFN and did really not need an exception from MFN, which certainly implies that a CU would contribute to multilateralism, not the opposite.*

⁸ *The Doha round was launched 2001 and is called the "Doha Development Agenda". It is intended to rebalance the world trading system in favor of the developing countries, through greater market opening and new trade rules adjusted to the ever changing landscape of the "New Economy"*

⁹ *The World Trade Report 2007, p 304*

¹⁰ *Crawford Jo- Ann & Fiorentino Robert V. "The Changing Landscape of Regional Trade Agreements", Discussion Paper No 8, World Trade Organization, Geneva, Switzerland, 2005, p 1*

http://www.wto.org/english/res_e/booksp_e/discussion_papers8_e.pdf

sarcastic re-labeling of the “Most Favored Nations” principle to the “Least Favored Nations” principle!

Another clearly visible trend is that RTAs are becoming more focused on subjects other than trade, such as competition policies, mutual recognition, movement of persons, investments etc. Even as the focus of RTAs is shifting towards adjacent issues, RTAs are still important when discussing world trade liberalization since non-trade issues most certainly would be more efficiently treated under the WTO. In fact, many of the issues which NGOs call for are in the schedule of the Doha development agenda, however, the negotiations has been put on hold due to difficulties in reaching agreements.¹¹

In this section, a political point of view is taken on the RTA dilemma and a very important question from this perspective is “Why are so many countries ready to accept rules and disciplines at the bilateral level that they are not prepared to accept at the multilateral level?”¹²

¹¹ WTO, Ministerial Conference Fourth Session Doha, 9-14 November 2001, WT/MIN(01)/DEC/1 (20 November 2001) adopted on 14 November 2001

¹² Speech by **Lamy, Pascal** in Bangalore, India 2007 on the topic; “Multilateral or bilateral agreements: which way to go?” http://www.wto.org/english/news_e/sppl_e/sppl53_e.htm

6 What is a RTA and how does it work?

RTAs or RPAs (Regional Preferential Agreements) are two umbrella terms for the same thing, namely a CU or a FTA. A CU/FTA is a bilateral, or plurilateral, agreement between countries (customs territories),¹³ in this case WTO-member-countries. The formation of an FTA or CU is regulated under Article XXIV GATT 1994, which provides for more beneficial treatment between members to a RTA than that afforded by the schedule of concessions negotiated under the WTO. Article XXIV, consequently, provides for an exception from the MFN-Principle.¹⁴

The MFN exception stated in Article XXIV may at first sight seem illogical, since the only way to be excused from applying non MFN consistent and discriminatory trade preferences is to completely discriminate, i.e. MFN denies all discriminatory preferences meanwhile the MFN exception in Article XXIV allows discriminatory preferences if they are completely discriminatory against the non RTA members. This issue was addressed by Viner when he stated that:

*“Free-traders sometimes in almost the same breath disapprove of preferential reductions of tariffs but approve of customs unions, which involve 100 per cent preference... If this distinction is made to rest, as often to be the case, on some supposed virtue in a 100 per cent, which suddenly turns to maximum evil at 99 per cent, the degree of evil tapering off as the degree of preference shrinks”*¹⁵

The purpose of the somewhat illogical requirement of 100% preference between the members of a RTA is of course to disable a pick and choose strategy of preferences between the RTA members, such a strategy would likely result in a selection of preferences that affords RTA-members protective means against non RTA-members. Consequently, a pick and choose strategy cannot contribute to multilateral free trade and therefore Article XXIV requires that RTA members removes all restrictive

¹³ *Customs territories is the term used in Article XXIV GATT to distinguish the members of GATT, it is a preferred term due to the fact that a customs union, however consisting of several countries, are still only one customs territory. Consequently, parties to WTO are de facto customs territories, not countries.*

¹⁴ *The legal side of this issue will be discussed in Section III of this paper*

¹⁵ **Viner, Jacob**, “The Customs Union Issue”, 1950, p 49

regulations to trade internally, with no regard to whether the restrictions are such that benefit only the RTA members or only non-RTA members or both, i.e. no pick and choose.

6.1 Examples of RTAs

EC, (The European Community) is the largest and most successful RTA in force as of today; furthermore, it is the only CU which speaks with one voice in the WTO. Others are ASEAN, (The Association of South East Asian Nations), NAFTA (The North American Free Trade Agreement), MERCOSUR (a Latin American CU), CARICOM (Caribbean Community and Common Market, CU), EFTA (The European Free Trade Agreement), LAIA (Latin American Integration Association) etc. A rather interesting development regarding NAFTA is the rumored substitution of NAFTA for a CU similar to the EC.¹⁶

6.2 Recent increase of RTAs

As said earlier, there has been a huge increase in the numbers of RTAs created lately. To visualize this; between 1943 and 1957 no RTAs were in force, from 1958 to 1995 (the GATT years) 124 RTAs were notified, however only 38 of those are in force as of 2005. Today 205 RTAs are in force.¹⁷ There are currently 194 RTAs under examination, and according to Pascal Lamy, Director General of WTO, all are expected to enter into force before 2010.¹⁸ All together, almost 400 RTAs will be in force within three years (*see Table 1*), out of these 400 RTAs 90% are FTAs, and CUs account for less than 10%.¹⁹

¹⁶ See; “The Security and Prosperity Partnership of North America”, <http://www.spp.gov/>, The SPP denies any implications of pursuing a customs union between Canada, USA and Mexico, however, the former Mexican president Vicente Fox, has revealed that creating a CU between the NAFTA countries was at least on his agenda. See for example;

<http://www.nytimes.com/2007/11/04/books/review/Thompson.html?n=Top/Reference/Times%20Topics/People/T/Thompson,%20Ginger>

<http://www.washingtonpost.com/wp-dyn/content/discussion/2007/11/05/DI2007110501135.html>

¹⁷ July 2007, http://www.wto.org/english/tratop_e/region_e/region_e.htm

¹⁸ Speech by **Lamy, Pascal** in Bangalore, India 2007 on the topic; “Multilateral or bilateral agreements: which way to go” http://www.wto.org/english/news_e/sppl_e/sppl53_e.htm

¹⁹ http://www.wto.org/english/tratop_e/region_e/region_e.htm

On the other hand, RTAs are not immortal, the 2004 accession of ten nations to the EU, overnight, eliminated 65 RTAs.²⁰ This is an example of how deep regional integration may promote world trade liberalization by decreasing the total number of voices in the WTO, facilitating less complicated decision making.

An overwhelming share of all RTAs notified to the WTO are bilateral (between two countries), as opposed to plurilateral (more than two countries). In February 2005, out of all RTAs which had been notified and entered into force 75% were bilateral agreements, moreover, of all RTAs under negotiation at that time, almost 90% were bilateral. Consequently, bilateral FTAs are preferred to CUs and plurilateral FTAs.²¹

WTO-countries as well as non-WTO-countries are averagely participating in five RTAs, however, some countries are engaged in significantly more than five, as an example, the EC is engaged in 29 different RTAs.²²

6.3 FTAs contra CUs

The main reason for WTO member's preference of bilateral FTAs before multilateral FTAs or CUs is probably the mere fact that bilateral FTAs are easier to conclude than multilateral FTAs and certainly a lot easier than a CU. When a country has decided that MFN deviation is an attractive way to enhance its trade policies it simply has the choice to accomplish this in two ways, one of them is harder than the other, therefore FTAs in general and bilateral FTAs in particular are the natural choice when seeking the benefit of MFN deviation. The proliferation of, especially, FTAs is disturbing since FTAs tends to not contribute as much to the MTS as a deeper integration such as a CU. However, even if FTAs threatens to deteriorate the MTS through the application of complex RoOs creating a "spaghetti bowl" effect (*see 8.1.1 and 11.5*), FTAs also entails some apparent benefits, i.e. FTAs are *de facto* easier to conclude

²⁰ 1 May 2004, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia became members of the European Community.

²¹ Crawford Jo- Ann & Fiorentino Robert V. "The Changing Landscape of Regional Trade Agreements", Discussion Paper No 8, World Trade Organization, Geneva, Switzerland, 2005, http://www.wto.org/english/res_e/booksp_e/discussion_papers8_e.pdf, p4

²² Medvedev, Dennis, "Preferential Trade Agreements and Their Role in World Trade" World Bank Policy Research Working Paper 4038, 2006, p 14, http://www.wds.worldbank.org/external/default/WDSContentServer/TW3P/IB/2006/10/13/000016406_20061013162647/Rendered/PDF/wps4038.pdf

than CUs, this spurs elimination of trade barriers, simply because more barriers to trade are dismantled than if the FTA exception was unavailable, i.e. a larger number of trade barriers are dismantled due to the FTA inclusion resulting in an overall accelerated trade liberalization process. Moreover, FTAs may develop into deeper integration such as a CU at a later stage, for example many of the eastern European countries were engaged in FTAs with the EU prior to their entrance into EU. The question is if the FTA trade off is on the whole more positive than negative for MTS, this question is often referred to as the discussion about RTAs as building blocks or stumbling blocks of multilateralism.²³

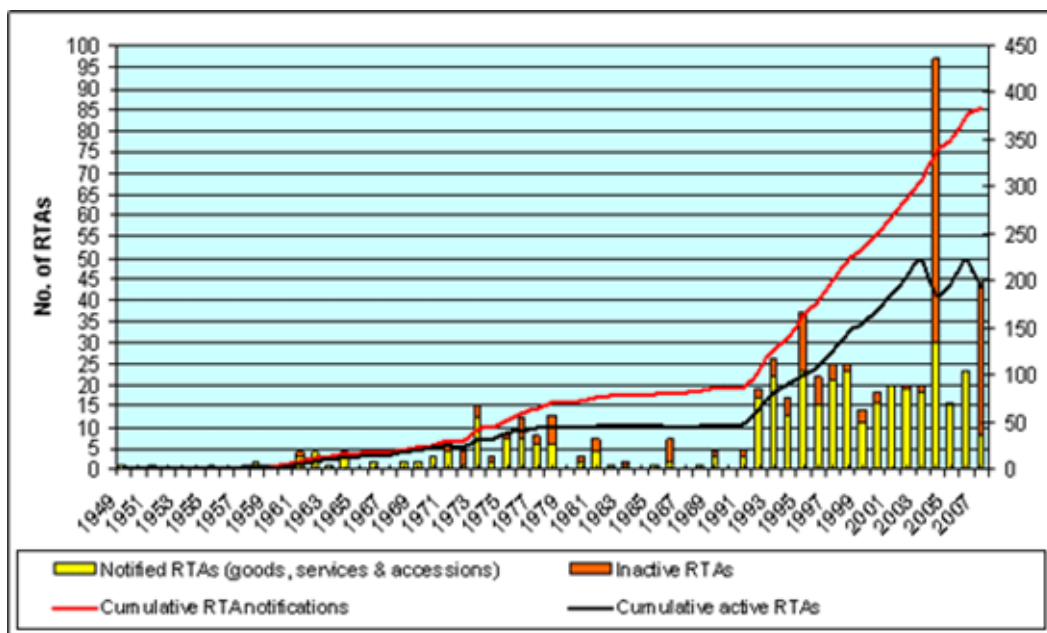


Table 1, Number of RTAs 1949-2007²⁴

²³ See for example, **Damro, Chad**, “The Political Economy of Regional Trade Agreements” in **Lorand Bartels, and Federico Ortino** “Regional Trade Agreements and the WTO Legal System”, 2006, p 25, 39

²⁴ the WTO Secretariat

7 Reasons for RTA proliferation

7.1 *The path of least resistance*

The fact that 75% of all RTAs are bilateral and that 90% of all RTAs are FTAs reveals that the overwhelming majority of countries seeking MFN deviation through Article XXIV prefers to conclude bilateral FTAs to meet the standards stipulated in Article XXIV. This choice is apparently based upon the simplicity of concluding these entities in comparison to for example a multilateral CU as the one between the EU member states.

The differences between the EU and a bilateral FTA are immense, the EU is a project which has been under development for decades, meanwhile a bilateral FTA can be concluded and in force within a matter of years. Moreover, the members of a FTA retains all sovereignty over foreign trade policy meanwhile a CU presupposes political integration as the members of a CU partially surrenders sovereignty to the CU. It is therefore easy to see the benefit of ease of FTAs compared to CUs. However, the question arises whether the purpose behind the formation of a FTA is the same as the purpose of a CU such as EU, i.e. closer relations, peace, prosperity and equality between the member nations, and if a FTA benefits MTS to the same extent as a CU.

It is highly doubtful that FTAs benefits MTS to the same extent CUs does because of the fact that FTAs does not remove all internal trade barriers to the same degree as a CU, neither does FTAs speak with one voice in WTO, thereby accommodating easier decision making. In addition, the most obvious downside of FTAs is the necessary creation of rules of origin, to prevent non FTA members from enjoying intra-FTA preferences. The overlapping web of RoO is definitely complicating trade and has been accused of being a major barrier to trade, in addition RoOs increases transaction costs, all together RoOs unquestionably complicates international trade. (*See 8.1.1 and 11.5 for more about RoO*)

Nevertheless, FTAs are not all bad, FTAs actually contributes to the dismantling of barriers to trade due to the relative ease of concluding a FTA, i.e. barriers which would not have been dismantled unless the FTA option was available. On the whole the trade off for a FTA seems to be that “retained sovereignty leads to flexibility but

also to complexity”); flexibility regarding the FTA formation, but complexity due to the intricate RoOs.²⁵

7.2 Economics

One of the major driving forces behind most RTAs is obviously facilitation of economic benefits, which means that participating in RTAs is simply good business. A prerequisite for concluding a RTA is the conception of a win-win situation, i.e. two, or several countries recognizes a window of opportunity to establish a reciprocal trade agreement that will benefit all participating countries economies. For example the EC, is currently evaluating a possible FTA with India, Korea and ASEAN, the estimated economic benefits are publicized in a report, stating that;

“The studies, based on realistic liberalisation outcomes, suggest:

- The agreements will boost EU exports to ASEAN by 24.2%, to India by 56.8% and to Korea by 47.8%. The three deals combined could increase total EU exports (1.3 trillion euros in 2005) by 3.23%. They offer an increase of GDP of 0.13% for the EU.*
- ASEAN would see an increase of its exports to the EU of 18.5%, Korea would see exports to the EU rise by 36% and India by 18.7%*
- By going beyond what is possible in the WTO, particularly in areas such as services and investment, the three FTAs could add as much as 40% to the benefits of a successful Doha Round for the EU.”²⁶*

The above excerpt confirms the suggested reciprocal economical benefit theory.

²⁵ Interview with **Cramér, Per**, 2008-01-24

²⁶ Memo related to the Press release from the same day[2007-04-23] on the FTA which is under negotiaton with India, Korea and Asean, The European Commission, http://trade.ec.europa.eu/doclib/docs/2007/april/tradoc_134543.pdf

7.3 Increasing difficulties to pass agreements under WTO

Generally, the major problem of WTO negotiations is the increasing member list. It is basically hard in any negotiation to get 151 parties to agree on any matter. For that reason the zone of agreement diminishes in the very same rate as the member list increases. Along with the increasing number of members, the homogeneity among them is reduced, in simple terms; the discrepancy between for example Chad and Sweden is so wide it is almost incomprehensible. Chad has a BNP per capita of 583 US dollar while Sweden has a BNP per capita of 38 993 US dollars. The Infant Mortality Rate in Chad is 101/1000, in Sweden 3/1000. In Chad 4,8% of the population is living with HIV while the world average is 1,1%.²⁷ To conclude an agreement that benefits both countries, in consensus with 149 other countries, is obviously next to impossible.

The effects of the increasing member count can be seen in Table 2 when analyzing the length of the negotiating rounds from 1961 and forward, compared to the number of WTO members during the same period.

| | | | |
|---------------|---------------|---------|------------------|
| Dillon Round | 2 years | 1961-62 | App. 40 members |
| Kennedy Round | 3 years | 1964-67 | App.60 members |
| Tokyo Round | 6 years | 1973-79 | App.80 members |
| Uruguay Round | 8 years | 1986-94 | App. 100 members |
| Doha round | Started 2001- | ongoing | App.150 members |

Table 2: Historical length of negotiation rounds

Not surprisingly, this clearly indicates that the zone of agreement is shrinking correspondingly with increasing number of members.

However, the proliferation of RTAs may assist the multilateral negotiations; RTAs such as the EC, cuts down the number of WTO-negotiators from 27 to 1, since EC speaks with one voice in WTO. This is obviously beneficial for the process of reaching agreement within the WTO, and it can also be observed that the EC member states, North-South, are becoming increasingly homogeneous as an effect of the EC-framework. The harmonization process is quickened by the implementation of different EC-programs such as ERASMUS, which has provided a basis for a common

²⁷ Reference from *Encyclopedia Britannica and Nationalencyklopedin figures from 2005*

European identity which would not have been imaginable 20 or 30 years ago.²⁸ This shows that economic integration can be positive in many ways other than merely economics.

7.4 Widening scope of WTO negotiations, non trade issues

It has been argued that the scope for RTAs would shrink since the tariffs negotiated under WTO and the MFN-Principle is fairly low (approximately 3-4 %)²⁹ thus the incitement for RTAs would diminish. But on the other hand the introduction of non-economic matters in the WTO negotiations, such as environmental and labor issues, complicate negotiations and makes bilateral trade agreements comparably easier to conclude.

7.5 Quicker to conclude

Since negotiations under WTO are striving for consensus among 151 member states, they will generally stretch out over a considerably longer period of time than corresponding bilateral negotiations, (*see Table 2*). One could say that RTAs function as a short cut or a quick fix when multilateral negotiations are grinding to a standstill.

7.6 RTAs as “The leading edge in multilateralism”

RTA proliferation might benefit WTO progress since RTA negotiations could function as an experimental workshop. Thus, experiences drawn from RTA negotiations would simplify sharp negotiations during, for example, the Doha round. In addition, RTAs can more easily explore new territories, such as labor standards and environmental standards, than multilateral negotiations can, because of the difficulties in finding consensus among the 151 WTO members.³⁰ Furthermore, negotiators from less developed countries can use regional negotiations as training and preparation for the more complicated WTO negotiations. Moreover, if the multilateral negotiations on non-trade issues under the Doha Round, fails, that void must be filled and RTAs are the only alternative left.

²⁸ ERASMUS is a European student exchange program and is short for European Action Scheme for the Mobility of University Students

²⁹ Kleen, Peter lecture 2007-03-14, the average tariff rate was 4,7 % after the Tokyo round see also, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm

³⁰ Ibid, and speech by Lamy, Pascal in Bangalore, India 2007 on the topic; “Multilateral or bilateral agreements: which way to go?” http://www.wto.org/english/news_e/sppl_e/sppl53_e.htm

7.7 GATT, an RTA in itself

An interesting argument from Whalley is that:

*“The GATT as it grew after 1957 with the formation of the EC through the Kennedy and Tokyo rounds can be seen in effect as a form of bilateral accommodation between the two largest entities in the trading system...multilateralism in the GATT can be viewed as a peace treaty between the US and EC that they would mutually extend whatever they negotiated with third parties to each other”.*³¹

He elaborates further that the US-Canada RTA in the late 1980's was essentially a way for the US to push the multilateral negotiations under the Uruguay Round into closure. This perspective on RTAs is obviously an argument for the development of RTAs since this implies that every RTA might be the embryo of something much larger and more important.

7.8 Negotiators/ politicians personal agenda

A sociological motivation for the RTA proliferation which has been argued is the mere fact that to be appointed as a negotiator for your country is very prestigious, and carries with it several benefits such as future commissions, high wages etc.³² This is sometimes called for as one explanation to the increasing numbers of RTA negotiations, the logic behind this would be that it is in the negotiators interest to have a steady stream of negotiations pending. In addition to this, bilateral negotiations can be used as political means to demonstrate activity and progress in foreign affairs to the domestic public. For that reason the real outcome of the negotiations might not be very important in itself.

³¹ **Whalley John**, "Recent Regional Agreements: Why So Many, So Fast, So Different and Where Are They Headed?" (September 2006). CIGI Working Paper No. 9 Available at SSRN:

<http://ssrn.com/abstract=941445>, p 25

³² *Ibid*, at 6

8 Negative effects of RTA proliferation

8.1 Economics

The economic benefit of participating in RTAs, as mentioned above in 7.2 is supposed to be a major driving force behind RTA proliferation, or is it? It is of great importance to establish whether the economic benefits of RTAs are superior to the corresponding benefits which can be facilitated through multilateral negotiations under WTO. When concluding this analysis it is very important to stress that the point of comparison is not equal to a zero-point. That is to say that the point of comparison cannot be supposed to be a trading environment where all rules, duties, languages etc. are completely harmonized. Even in the best of MFN-worlds, there would still be trade barriers remnant, such as language confusion, remaining MFN-tariffs above zero, quantitative restrictions etc. Consequently, when comparing bi/plurilateralism to multilateralism one must bear in mind that multilateralism is not trade-utopia.

8.1.1 RoO transaction costs

The famous American economist, Jagdish Bhagwati invented the expression “The Spaghetti Bowl” to describe the overlapping web of RTAs.³³ One of the components of FTAs (CUs does not use RoOs to the same extent as FTAs) that makes the “Spaghetti Bowl” even more intricate is the complicated Rules of Origin (RoO). The RoOs are supposed to make sure that the preferential treatment under a FTA, ends up in the right pockets.³⁴ It is a necessity to ensure that products which shall receive preferential treatment *de facto* originates in the counterparts country. This is a very difficult task, in certain cases it is necessary to calculate the share of 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 shall therefore not receive preferential treatment. Imagine a country which is a member of 10 RTAs with different RoOs and the complexity

³³ **Bhagwati, Jagdish and Krueger Anne O**, “*The Dangerous Drift to Preferential Trade Agreements*”, AEI Press, 1995

³⁴ **Bhagwati, Jagdish, Greenaway, David, and Panagariya, Arvind** “*Trading Preferentially: Theory and Policy*” in **Huw, David Dixon** “*Controversies in Macroeconomics: Growth, Trade and Policy*”, Blackwell Publishers, 2000; **Bhagwati, Jagdish**, “*Testimony, Subcommittee on Domestic and International Monetary Policy, Trade and Technology; April 1, 2003; U.S. House of Representatives*”, <http://financialservices.house.gov/media/pdf/040103jb.pdf>. In these papers Bhagwati makes clear that the “Spaghetti Bowl” metaphor is mainly representing the web of rules of origin which is an effect of FTA proliferation.

becomes obvious. In addition, RoO complicates the production process since a producer who is interested in receiving preferential treatment must tailor the product for different preferential markets to be able to benefit from low/no tariffs. In many cases it has been discovered that the tailoring process is more time consuming and expensive than the value of the preferential tariffs. As a result many producers, who theoretically could receive preferential treatment on their export products, do not. They, simply, do not find it profitable to adapt to the RoO, instead they choose to pay the higher WTO-tariffs because of the fact that the difference between preferential tariffs and WTO tariffs are too small.

The above dilemma is treated thoroughly in a paper by Dennis Medvedev, instigated by the World Bank, 2006.³⁵ Medvedev has gathered information about all RTAs regarding goods, (not services) whether or not notified to the WTO, in general, only RTAs which are notified to the WTO are analyzed. Between 1958 and 2004 non-notified RTAs were 133 meanwhile notified only counted 99, which proves the importance of including the non-notified-RTAs.³⁶

The purpose of the World Bank analysis is to estimate at what level a MFN tariff becomes more “expensive” than the corresponding FTA/RoO-tariff of zero, or formulated as a question; what is the price of RoO adaptation? Since a FTA-tariff of zero, i.e. eliminated duties, always comes with a substantial set of RoO, a cost for the administration and adaptation of products in order to meet the RoO must be added to the total shipment value.³⁷ Consequently, the cost for an exporter to export a good into a WTO-country which is also a FTA-partner may be calculated in two ways. The exporter can choose to pay the MFN-tariff or he can choose to meet the RoO in order to avoid duties entirely. Now, if the MFN-tariff is low, e.g. 5%, the gain the exporter can make is maximally 5%, however, meeting the RoO involves added costs and a burdensome paper administration. Moreover, RoOs are often “more strict than necessary to accomplish this goal [avoiding trade deflection], resulting in higher costs

³⁵ *Medvedev, Dennis, "Preferential Trade Agreements and Their Role in World Trade" World Bank Policy Research Working Paper 4038, 2006, http://www.wds.worldbank.org/external/default/WDSContentServer/TW3P/IB/2006/10/13/000016406_20061013162647/Rendered/PDF/wps4038.pdf*

³⁶ *Ibid, at 16*

³⁷ *See Section III, 2.5 for a deeper discussion on Rules Of Origin*

for exporters and consequently, under-utilization of trade preferences”.³⁸ This means that, despite the fact that most countries are members to an average of five RTAs, the share of preferential RTA trade is not corresponding to the degree of RTA-participation.

Medvedev arrives at the conclusion that the cost for RoO compliance is equal to a MFN-tariff of between 3-6% of shipment value and based on those figures, he arrives at a total share of preferential RTA trade at between 15.4 – 11.4% of world trade.³⁹ This is obviously a very low figure in comparison to the degree of RTA-participation, indicating that many RTAs are not fully utilized, or not utilized at all. The reason for this is supposedly the rather low MFN-tariffs which render RTA-tariffs useless when adding costs for RoO compliance. These findings suggest that one of the major driving forces behind RTA proliferation, i.e. economic gain, either is chimerical or simply is *not* the major driving force? (*see also 11.5 Rules of Origin*)

8.1.2 RoOs-MFN

In a FTA, RoO replaces MFN, resulting in the very opposite of MFN, namely a lack of conformity instead of conformity of regulatory standards. This is what Bhagwati referred to when he gave birth to the expression “Spaghetti Bowl of RTAs”.⁴⁰ It is self explanatory that many different trade rules are more complicated than a single set of trade rules. In this aspect, the “Spaghetti Bowl” is hindering free trade instead of promoting it. The “Spaghetti Bowl” is mainly a problem for small and medium sized exporters, since RoOs add “fixed” costs to exportation in the form of burdensome paper administration and adaptation of the manufacturing process to comply with

³⁸ *Medvedev, Dennis, "Preferential Trade Agreements and Their Role in World Trade" World Bank Policy Research Working Paper 4038, 2006, p 22. footnote 27*
http://www.wds.worldbank.org/external/default/WDSContentServer/TW3P/IB/2006/10/13/000016406_20061013162647/Rendered/PDF/wps4038.pdf. Medvedev further explains; “These studies also show that costs of meeting ROO tend to be higher in PTAs and unilateral preference schemes involving high income partners. Thus, ROO often go beyond simply means of preventing trade deflection and become an instrument of protection, similar to other non-tariff barriers. On the other hand, ROO can also create trade in certain sectors and therefore lead to an increase in preference utilization. This has occurred with automobile and textile and clothing industries within NAFTA, where strict ROO encouraged industrial development in the member states and buttressed cross-border trade in the above sectors. Of course, more trade and higher rates of preference utilization only last as long as the artificial policy barriers that created them, and we have witnessed this with the decline of Mexican textile and apparel exports to the US following the phase-out of the Multi-Fiber Arrangement (MFA) quotas”.

³⁹ *Ibid, at 48*

⁴⁰ *Ibid, at footnote 29*

RoOs. Large exporters can, by economy of scale, dilute the additional costs while small exporters cannot carry the extra burden, thus affording large companies with a competitive advantage.

Multiple sets of RoOs may not only cause purely economic disadvantages, they may also cause inefficient border controls, delaying transports and in effect cause economic injury, injury which is out of control for exporters, but for which they may have to shoulder the burden of responsibility in order to not upset the importer-exporter relations.

8.2 Creates trade diversion

It is a common point of view that RTAs divert more trade than they create. The logic behind this is that RTAs benefits trade within the RTA and as a result diverts trade from outside the RTA. Moreover, as an effect of this, RTAs are accused of replacing healthy global competition and efficient global allocation of resources for protectionism and ineffectiveness.⁴¹

8.3 Bandwagon effect

The main reason for concluding an RTA is normally to obtain preferential treatment in relation to one or several trading partners, and consequently “lock out” non-members. However, non-RTA-members will generally try to conclude an RTA with one of the nations inside the RTA in order to benefit from the same preferences. This is called the “Bandwagon Effect”, and this, according to Pascal Lamy, means that; *“the more agreements you have, the less meaningful the preferences would be”*.⁴²

8.4 Cannot solve global issues

Since the nature of Regional trade agreements is just that they are regional, they cannot solve global problems e.g. environmental or regulatory issues such as antidumping, subsidies and RoO. These problems must be solved on a global level in

⁴¹ See for example; **Mathis James H**, “Regional Trade Agreements and Domestic Regulation. What Reach for ‘Other Restrictive Regulations of Commerce’?” in **Bartels, Lorand, and Ortino, Federico** “Regional Trade Agreements and the WTO Legal System”, 2006, p 82 and **Viner, Jacob**, “The Customs Union Issue”, 1950, p 45

⁴² Speech by **Lamy, Pascal** in Bangalore, India 2007 on the topic; “Multilateral or bilateral agreements: which way to go?” http://www.wto.org/english/news_e/sppl_e/sppl53_e.htm

order to succeed, this is the characteristics of those problems, and it is rather ironic that those problems have lead to the opposite, i.e. RTAs.

8.5 Can be used for market manipulation

Zahrnt's⁴³ main arguments against regionalization, even if he is mostly positive concerning the matter, is that member states of an integrated trade region may find it beneficial to set higher tariffs towards non members than each single constituent country would have otherwise. The thought is that a large integrated market has the ability to affect the global demand on a certain product in order to push the world market prices downward. The incentives to manage business in this way are growing with accelerated regional integration. Although this behavior is prohibited according to GATT article XXIV, it is very difficult to calculate the fluctuations in average tariffs on a wide range of products in between for example 10-20 member states of a CU. Even if it is possible to calculate the average tariffs it will still be impossible to calculate the effects of other restrictive measures such as technical barriers to trade and standards.

8.6 Developing countries lose out

8.6.1 Developing countries has a weaker negotiating position

Freund means that it may be harder for countries with a weak economy to bargain with a more successful counterpart in bilateral trade negotiations. Consequently, reciprocity, which is a highly important element under the GATT-agreement is marginalized when negotiating RTAs. It has been shown that reciprocity is only preserved between countries with equal prerequisites or so called north-north, south-south trade agreements. North-south trade agreements will in most cases favor the north party, who has more valuable trading chips to offer than the poorer counterpart. This development leads to the hollowing-out of the pillars of the GATT agreement such as the MFN-Principle and reciprocity. However, article XXIV calls for "trade barriers to be eliminated with respect to substantially all trade (SAT) between the constituent territories".⁴⁴ "Thus by definition preferential trade agreements involve

⁴³ *Zahrnt Valentin*, "How regionalism can be a pillar of a more effective world trade order" *Journal of World Trade*, Vol. 39(4), Kluwer Law International, The Netherlands, 2005

⁴⁴ Article XXIV: 8(a)(b) GATT 1994

some kind of reciprocity because both sides are expected to make full trade concessions. But unlike multilateral negotiations, this does not necessarily yield equivalent concessions since an agreement can involve vastly different trade barriers, yielding gains in market access that are far from symmetric. In addition, some sensitive sectors are typically excluded, and many other types of trade barriers, such as antidumping claims or technical standards can remain in place, or even increase to offset tariff concessions”.⁴⁵

8.6.2 Replaces non-reciprocal Generalized System of Preferences (GSP)

The Generalized System of Preferences (GSP) allows developed countries to disregard the MFN-principle in favor of developing countries. In practice, the developed country eliminates all tariffs regarding trade with a developed country and at the same time declines their right of reciprocity. Consequently, the developing country receives very beneficial trade concessions without having to lower their tariffs on imported goods. This is done to supply the weaker nation with a trade advantage that can be used to “kick start” their economy. The predicament with RTAs is that they are replacing existing GSP’s, the effect of this is that the developing country trades a non reciprocal agreement for a less beneficial reciprocal. An example of this is the replacement of the Cotonou agreement for the establishment of an RTA between EC and the ACP (African, Caribbean and Pacific group of countries).⁴⁶

8.6.3 Drains administrative funds

Crawford and Fiorentino argue that developing countries in the third world may suffer from the widespread use of RTAs. This is due to the fact that the web of several overlapping RTAs is considerably more complex and challenging to utilize than the multilateral agreements concluded by WTO. Developing countries has comparably smaller administrative budgets rendering successful negotiations and/or a successful utilization processes difficult due to lack of resources. This means that in the event of

⁴⁵ **Freund, Caroline**, “ *Reciprocity in free trade agreements*”, p 2, World Bank, Washington, USA, 2003,
[http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/1daa46103229123885256831005ce0eb/5caa488a9e5d4cff85256caa005ba2b5/\\$FILE/Freund%20reciprocity%20jan-03.pdf](http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/1daa46103229123885256831005ce0eb/5caa488a9e5d4cff85256caa005ba2b5/$FILE/Freund%20reciprocity%20jan-03.pdf)

⁴⁶ **Crawford Jo- Ann & Fiorentino Robert V.** “*The Changing Landscape of Regional Trade Agreements*”, Discussion Paper No 8, World Trade Organization, Geneva, Switzerland, 2005,
http://www.wto.org/english/res_e/booksp_e/discussion_papers8_e.pdf, p 8

a successful negotiation, they might not be able to make use of the preferences due to a complex and economically burdensome utilization of the agreement, thus the agreement is only benefiting the stronger party.

9 Political/Economical Conclusion

A wide array of *pros* and *cons* can be recognized when it comes to explaining the political and economical forces behind the current RTA proliferation. Nonetheless it is hard to point out a certain motivation for or against RTAs which is applicable to all sorts of RTAs; the motivation for a country to engage in RTA negotiations are simply too inconsistent. Even though the obvious preference of the easily concluded FTA before the more difficult CU may not provide a reasonable explanation to the RTA proliferation itself, it may very well be a catalysis providing the uncomplicated means to afford MFN deviation, and consequently contributing to the RTA proliferation. This means that, had it been more difficult (e.g. MFN deviation afforded to CUs only) to conclude a RTA many countries may have restrained from doing so unless it was for a very specific purpose. On the other hand, as pointed out above, the actual trade barriers removed within a FTA is one trade barrier less than if the FTA option was not available. Consequently, the *pros* and *cons* of FTAs must be weighed against each other to arrive at a reasonable conclusion. However, even when considering the *pros* of FTAs the *cons*, such as RoOs and shallow integration, by far outweigh the *pros* according to this author.

Moreover, a common attribute in the RTA proliferation seems to be frustration over the sluggishness of multilateral negotiations, leading to the second best solution of regionalism instead of increasing efforts in the multilateral negotiations. The characteristics of regionalism as being second best is probably widely accepted, in despite of this, an overwhelming share of the WTO-countries resort to the second best choice. It is this psychology which is interesting; the so called band wagon effect is certainly for real. No one wants to be left behind, and this mass-psychosis leaves a void in the multilateral development, simply because everybody are too busy catching the RTA-train. Perhaps this is an answer to Pascal Lamy's question; "Why are so many countries ready to accept rules and disciplines at the bilateral level that they are not prepared to accept at the multilateral level?"

It is unfortunate that so many countries resort to regionalism in general and shallow, bilateral regionalism in particular. The shallow, bilateral trade agreements are complicating multilateralism more than deeper integration as for example the EC. It seems contrary to the purpose of Article XXIV that a bilateral FTA should be allowed

MFN exemption on the same basis as the EC, the character of those entities are so different that they cannot be compared.

SECTION III

THE LEGAL ARENA, ARTICLE XXIV

10 Introduction

Article XXIV is an exception from the MFN principle as set forth in Article I GATT. The MFN exception is codified in the chapeau of paragraph 5, however not expressly. Nevertheless, the MFN exception can be understood from the formulation, “the provisions of this agreement...shall not prevent the formation of a CU/FTA...”. The permission to deviate from MFN is conditional, as it is only afforded to entities of a certain status. The operative requirements for a formation of a CU or a FTA to be in compliance with GATT Article XXIV can be roughly divided into two paragraphs, namely paragraph 5 and 8.⁴⁷ Paragraph 8 stipulates the initial conditions to be met as it defines the entities which may qualify for MFN deviation:

- customs unions
- free trade areas, and
- interim agreements leading to a customs union or a free trade area⁴⁸

Paragraph 8 is commonly called the internal requirements paragraph. The external requirements in paragraph 5 are the second condition to be met when it stipulates the external conditions for CUs, FTAs or interim agreements to qualify for MFN deviation. Albeit, CUs and FTAs are essentially different entities, the majority of the requirements laid down for RTA qualification are similar between the two. The main requirements which apply to both FTAs and CUs are;

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 and,

⁴⁷ See, *Turkey-Textiles, Appellate Body Report, WT/DS34/AB/R, paragraph 57. for the division of the paragraphs in XXIV into operative and purposive paragraphs.*

⁴⁸ *The inclusion of Interim Agreements is found in paragraph 5(a)(b)*

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 major difference in requirements between CU/FTA formations are;

Paragraph 8(a)(ii) CUs

Requires the formation of a common external trade regime, i.e. a common external tariff policy, furthermore, a common external trade regime presupposes the creation of a common internal trade regime.

10.1 XXIV Drafting History

MFN and CUs has a history dating back some 150 years, since then the MFN principle, however not codified in any multilateral treaty, has been utilized as a general practice between countries or rather customs territories.⁴⁹ It was instinct of self preservation which spurred MFN treatment, applying discriminatory tariffs was in effect bad business, a country which devoted itself to such doings could surely expect retaliation in the form of withdrawal of concessions, quotas etc. The system was in that sense self-regulating.⁵⁰

CUs were also a part of international trade at that time, however, a CUs existence was not regarded as a MFN exception, on the contrary, a CU was expected to comply with the MFN principle. It was supposed that a CU was a true replacement of one or more

⁴⁹ **Viner, Jacob**, “The Customs Union Issue”, 1950, p 7. *About the Prussian Zollverein 1832*, (“German “Customs Union”)... established in 1834 under Prussian leadership. It created a free-trade area throughout much of Germany and is often seen as an important step in German reunification. The movement to create a free-trade zone in Germany received great impetus from economists such as Friedrich List, its most active advocate in early 19th-century Germany. In 1818 Prussia enacted a tariff law abolishing all internal customs dues and announced its willingness to establish free trade with neighbouring states. A decade later Prussia signed the first such pact with Hesse-Darmstadt. In 1828 a customs union was set up in southern Germany by Bavaria and Württemberg, joined in 1829 by the Palatinate; also in 1828 the central German states established a similar union, which included Saxony, the Thuringian states, electoral Hesse, and Nassau. In 1834 these were among the 18 states that joined in the Zollverein. Hanover and Oldenburg joined in 1854; the two Mecklenburgs, Schleswig-Holstein, Lauenburg, and Lübeck joined in 1867; and thereby all Germany outside Austria was included except Hamburg and Bremen, which adhered in 1888, 17 years after the establishment of the German Empire.” See, *Encyclopedia Britannica Online, Academic Edition*

⁵⁰ *Ibid*, at 14, “A country which would lightly terminate its obligation not to impose duties exceeding specified rates, even at the cost of surrendering corresponding claims against other countries, might nevertheless seriously hesitate before putting itself in a position where it could not claim most-favored nation treatment from other countries on grounds either of contractual rights or of international comity”

customs territories for a single customs territory, accordingly, that newly formed customs territory would fulfill its MFN obligations towards non-union members in the same way as any other customs territory.

“The fact that customs unions was generally regarded as compatible with most-favored-nation obligations had the result that customs unions was promoted where otherwise some other form of preferential arrangement would have been chosen.”⁵¹

Nevertheless, already at that point in time there were controversies about which criteria’s a CU was supposed to meet.

At the Bretton Woods conference in 1944 the first tentative steps towards GATT was taken, the conference resulted in the creation of institutions such as the World Bank and International Monetary Fund (IMF), in addition the attending parties recognized a need for a International Trade Organization (ITO) as an adequate contribution to promote trade, peace and predictability to global economical and political markets. The outcome of the ITO negotiations, the “ITO Charter” was finally signed in the spring of 1948; however, it never entered into force. The GATT was a combination of separately negotiated tariff concessions and the regulatory framework of the ITO. GATT was signed during the fall of 1947 and entered into force 1 of January, 1948 as a provisional treaty awaiting the ratification of the ITO charter. Eventually, GATT came to replace the ITO charter since the US congress failed to ratify it. Ever since the GATT entered into force, Article XXIV has remained unchanged, albeit amended and vigorously debated.⁵²

Many commentators has expressed regret over Article XXIV, this is a few samples;

“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)

⁵¹ **Viner, Jacob**, “The Customs Union Issue”, 1950, p 14

⁵² *During the Uruguay round of negotiations 1986-1994, XXIV was amended with the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994*

*impugns Article XXIV as an “absurdity” and a “contradiction”, while Dam (1970:275) brands it “a failure, if not a fiasco”*⁵³.

Until recently it was believed that the complicated wording of Article XXIV was the result of Britain’s colonial interests, it was supposed that Great Britain wanted a MFN exception to facilitate preferential trade with their colonies. In addition, since the GATT was born in the wake of World War II, the MFN exception in Article XXIV was supposedly intended to facilitate closer integration between European nations to promote lasting peace in Europe.⁵⁴ Those explanations are probably relevant regarding the CU-MFN-exception, while they do not present a satisfactory explanation to the FTA-exception.

The “Suggested Charter for an International Trade Organization, was a proposal from the American government for an international agreement designed to revive a liberated and competitive trading world”,⁵⁵ the charter constituted the foundation for today’s GATT treaty,⁵⁶ and the “Suggested Charters” article 33 corresponds to Article XXIV GATT, and it contained a solitary permission for CUs to deviate from MFN;

*“...A union of customs territories for customs purposes shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that all tariffs and other restrictive regulations of commerce as between the territories of members of the union are substantially eliminated and the same tariffs and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union.”*⁵⁷

The ITO charter Article 33 stipulated that “customs territories, not countries, would be the constituent bodies of the ITO, and the passage was designed to clarify that the

⁵³ All citations as cited in (**Chase, Kerry A.** “Multilateralism Compromised: The Mysterious Origins of GATT Article XXIV”, *World Trade Review* 5:1, 1-30, 2006, p 1)

⁵⁴ **Odell, John & Eichengreen, Barry**, “The United States, the ITO, and the WTO: Exit Options, Agent Slack, and Presidential Leadership” in **Krueger, Anne O.** “The WTO as an International Organization”, University of Chicago Press, 1998, p 8

⁵⁵ **Feis, Herbert**, “Suggested Charter for an International Trade Organization of the United States” *The Journal of Political Economy*, Vol. 55, No. 1, Feb 1947, The University of Chicago Press, p 84

⁵⁶ **Mathis, James H.** “Regional Trade Agreements and Domestic Regulation. What Reach for ‘Other Restrictive Regulations of Commerce in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 82

⁵⁷ *Ibid*, at 85

Charter would apply to countries with separate tariff structures, even if they were under common sovereignty, (as in a colonial system)".⁵⁸ The similar criterion is found in Article XXIV:1, and are consequently still valid.

*"Each (such) customs territory shall, exclusively for the purposes of the territorial application of this Agreement, be treated as though it were a contracting party"*⁵⁹.

A definition of a customs territory is found in XXIV:2;

*"For the purposes of this Agreement a customs territory shall be understood to mean any territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territory with other territories"*⁶⁰

Consequently, according to the original ITO charter it was not very sensational to afford MFN deviation to CUs, since there are only minor differences between a CU and a customs territory. The only difference that can be identified is that a CU is a coalition of customs territories. The similarities however, are numerous; all the attributes of a customs territory, such as a common internal market, a common external border, with common tariffs applied to the trade of territories not included in the union, are found in a CU as well as in a separate customs territory.

Article 33 of the ITO charter did not specifically require the creation of a common external border and internal market, however, the actual effect of applying the same tariffs and other regulations of commerce externally and substantially eliminating all tariffs and restrictive regulations of commerce internally are exactly the same.⁶¹ Article 33 is therefore significantly more logic than Article XXIV of GATT, considering the history of CUs, as stated above. Article 33 ITO relieves CUs from the MFN principle simply because a CU is a deeper integrated trade agreement than that of a FTA, and is therefore more likely to promote multilateralism than a shallow integration such as that of FTAs.

⁵⁸ Chase, Kerry A. "Multilateralism Compromised: The Mysterious Origins of GATT Article XXIV", *World Trade Review* 5:1, 1-30, 2006, p 4

⁵⁹ Article XXIV:1 GATT 1994

⁶⁰ Article XXIV:2 GATT 1994

⁶¹ The provision corresponds to XXIV:8(a)(ii) GATT 1994

A common way to assess a RTAs *raison d'être* is to evaluate the trade diverting as opposed to trade creating qualities of a certain RTA. Mathis explains the dilemma;

*“Since a preference granted between regional members will always raise a relative barrier to the trade of non-members, there is a clear tension presented by the Articles [XXIV] internal and external requirements”*⁶²

Consequently, by necessity, all RTAs raises trade barriers to non-RTA members. The question is if the trade creating effects of a RTA exceeds the trade diverting ones.

| |
|---|
| <p><u>RTA, trade diversion</u></p> <p>Intra-regional increase of trade produces extra-regional decrease, which means that trade is diverted from non-RTA members to RTA-members.</p> |
| <p><u>CU extra-regional trade creation</u></p> <p>Non-CU-members can benefit from economies of scale, since they can enjoy the benefits of the CUs common external trade regime, in addition the WTO benefits by the decreasing number of WTO-members participating in negotiations, since a CU can talk with one voice in the WTO.</p> |
| <p><u>FTA extra-regional trade creation</u></p> <p>RoOs may actually act as trade barriers, it is therefore uncertain if FTAs generate any extra-regional trade.</p> |

Table 3: CU/FTA trade diversion/trade creation

This analysis suggests that a core problem in the Article XXIV structure is the incorporation of FTAs as opposed to the original text where only CUs was afforded MFN deviation, the language of Article XXIV has not been suitably adapted to the special conditions applying to the FTA implementation. Alternatively, FTAs are a much too shallow entity to be afforded MFN deviation at all.

⁶² *Mathis, James H.* “Regional Trade Agreements and Domestic Regulation. What Reach for ‘Other Restrictive Regulations of Commerce in *Bartels, Lorand & Ortino, Federico*, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 81 [emphasis added]

So why was FTAs suddenly permitted MFN deviation? According to Jacob Viner, the expression “Free Trade Area” was first introduced at the Havana conference, he concludes that the definition of the concept of a Free Trade Area “must therefore be sought wholly within the text of the Havana Charter”.⁶³ The questions arising from this actuality is: what forces influenced the inclusion of FTAs into Article XXIV and who would benefit from it? Until recently it has been difficult to establish the reasons for the FTA inclusion because of the actuality that minutes and records from the XXIV working group has not been available as part of the Conference record or in its indexes.⁶⁴ However, Chase has studied a collection of US diplomatic cablegrams which reveals that the true motive behind the FTA inclusion in XXIV was a proposed FTA between USA and Canada.⁶⁵ The reason for USA and Canada to not engage in a CU is suggested to be that Canada’s relations to Great Britain would be harmed. Therefore, a “customs union light” was sought for, which would accommodate a trade treaty between USA and Canada without undue distress of Canada-Great Britain relations.⁶⁶

Prior to the Havana conference, US policy had been;

*“rehabilitation and strengthening of the MFN principle and the elimination of trade preferences- these goals US officials supported, and supported tenaciously. Yet there was the discrepancy that the Havana charter allowed easier escapes from MFN than previously had been accepted, or indeed than had existed in the Geneva draft. Where the final Charter departs from... or seriously compromises US objectives”.*⁶⁷

Viner’s testimony indicates that Chase’s discoveries might be correct, since something, obviously, changed US policy radically during the drafting of the Geneva

⁶³ **Viner, Jacob**, “The Customs Union Issue”, 1950, p 124

⁶⁴ **Mathis, James H.** “Regional Trade Agreements and Domestic Regulation. What Reach for ‘Other Restrictive Regulations of Commerce in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 86

⁶⁵ **Chase, Kerry A.** “Multilateralism Compromised: The Mysterious Origins of GATT Article XXIV”, *World Trade Review* 5:1, 1-30, 2006, p 16

⁶⁶ *Ibid*

⁶⁷ **Viner, Jacob**, “The Customs Union Issue”, p 110-111

Charter and the Havana Charter which were negotiated simultaneously.⁶⁸ The Canada-US FTA provides a logical explanation to the development in the Havana negotiations, and it also explains why Article XXIV was poorly drafted. Chase's theory indicates that the inclusion of FTAs in XXIV was supposed to complement the relatively complicated process of forming a CU with a less complicated alternative, namely FTAs, initially to facilitate the forming of the USA-Canada-FTA. In practice this means that a FTA is a less burdensome, and a less integrated RTA than a CU, and that the requirements for a formation of a FTA thus should be different and more restrictive in comparison to those of a CU since the characteristics of each entity are fundamentally different. However, most of the rules are similar, and this is the core reason behind the interpretational difficulties of XXIV.

10.2 Purpose of XXIV

When analyzing any legal text it is vital to understand the context and purpose of the construction. When analyzing international, multilateral law, like GATT, it becomes even more important because of the fact that such law is constituted between a multitude of independent actors who all have the theoretical right to interpose a veto or at least abandon talks. Consequently, the provisions of GATT must be viewed upon as a political compromise. In the light of these findings it is important to have the purpose of the provisions acting as a filter when deciphering the provisions.

All interpretation of GATT rules shall according to DSU Article 3.2 be

“...in accordance with customary rules of interpretation of public international law”⁶⁹

Public international law is codified in articles 31 and 32 in the VCLT and the GATT rules shall consequently be interpreted according to VCLT, this has also been confirmed by the Appellate Body on several occasions.⁷⁰ Article 31(1) VCLT reads,

⁶⁸ *The Havana Charter was signed, March 24, 1948, the Geneva Charter was signed October 30, 1947 and entered into force January 1, 1948. The Havana Charter was supposed to be the foundation of an International Trade Organization (ITO) but it never entered into force due to the US congress failure to ratify it. The Geneva Charter founded the GATT, which was supposed to be provisional, awaiting the Havana Charters ratification.*

⁶⁹ *Dispute Settlement Understanding Article 3.2*

⁷⁰ *US-Gasoline, Appellate Body Report, WT/DS2/AB/R, p 16-17, US-Line Pipe, Appellate Body Report, WT/DS202/AB/R, paragraph 244*

“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”⁷¹

Consequently, the purpose and context, as well as the ordinary meaning of the text shall act as guidance when interpreting Article XXIV of GATT. The object and purpose of Article XXIV is stated in paragraph 4, as well as in the Understanding on the Interpretation of Article XXIV of the GATT 1994.

“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.”⁷²

Paragraph 4 is backed up by the statement in the preamble text of the RTA Understanding.

“Members,

Having regard to the provisions of Article XXIV of GATT 1994;

Recognizing that customs unions and free trade areas have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade;

⁷¹ Vienna Convention on the Law of Treaties, Article 31(1)

⁷² Article XXIV:4 GATT 1994. The Turkey-Textiles Appellate Body Report, WT/DS34/AB/R, paragraph 57 reads, “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.”

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;”⁷³

Accordingly, the provisions of Article XXIV shall be interpreted with the above statements in mind, and in compliance with VCLT. The overall purpose of Article XXIV can be summarized in three words i.e. promotion of trade. This means that for a country to enjoy the benefits of the MFN exception held in Article XXIV, they must show creation and growth of world trade as opposed to protectionism, discrimination, diversion and decrease of international trade.⁷⁴ In addition it is important to remember the fundamentally different characteristics of CUs and FTAs and the difficulties arising from the fact that both entities are facing virtually the same regulatory framework under GATT Article XXIV.

⁷³ *Preamble of the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994*

⁷⁴ **Lockhart, Nicolas JS, & Mitchell, Andrew David**, “Regional Trade Agreements under GATT 1994: An Exception and its Limits” in **Mitchell, Andrew David**, “Challenges and Prospects for the WTO”, *Cameron May International Law & Policy*, London, 2005, <http://www.worldtradelaw.net/articles/lockhartmitchellrta.pdf>, p 222

11 Analysis of XXIV: 8 The Internal Requirements

XXIV:8 GATT 1994

For the purposes of this Agreement:

(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

- (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,*
- (ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;*

(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

Paragraph 8 is sequential to paragraph 4 and 5, paragraph 4 provides for the purpose of XXIV and paragraph 5 constitutes the MFN exception and points towards paragraph 5 to 9 as constituting the conditions for a RTA to receive and enjoy MFN deviation.

In paragraph 8 the internal requirements for a RTA 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)(ii) and FTAs under paragraph 8(b). The main difference between CUs/FTAs is found in paragraph 8(a)(ii) which requires a CU to establish a common external trade regime and, *a'contrario*, a common internal trade regime, i.e. harmonization of the CU-members internal trade regulations in order to accomplish a common external regime.

The provisions of 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 that a CU, (8(a)(i)), should eliminate duties and ORRCs on substantially all the trade between the constituent territories of the union, or at least on the trade of products originating from within the union. FTAs, however, are only required to fulfill the latter, i.e. eliminate duties and ORRCs on trade in products originating from any of the constituent territories of the FTA.

These different wordings together constitutes 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. For a FTA to be able to distinguish products originating from within the FTA from those from non-FTA members they have to apply RoOs. RoOs are a separately negotiated regulatory framework between the members of a FTA with the purpose of defining the exact requirements for each product to qualify as originating from within the FTA and accordingly receive a zero duty, instead of a MFN duty. (*see 11.5 Rules of Origin*)

For the reason of simplicity and because the requisites regarding FTAs and CUs are similar, and since the differences has already been treated above, the analysis will cover 8 (a)(i) and 8(b) simultaneously, however, 8(a)(ii) will be treated separately since that provision is unique to CUs.

11.1 Meaning of “Duties and Other Restrictive Regulations of Commerce”

In order to find a sound interpretation of Article XXIV, a definition of ORRC is of the utmost importance. Many problems surrounding Article XXIV should be eliminated if a precise definition on ORRC was provided.

“Other restrictive regulations of commerce”, as stated in paragraph 8(a(i))(b) are facially a simple combination of words, however, different interpretations on ORRC has covered thousands of pages. The ordinary meaning of the words in its immediate context can be sought in ORRCs relation to “duties” and the “bracketed list of exceptions”, in addition, the meaning of ORRC can be informed by “Other Regulations of Commerce” (ORC) in paragraph 5.

11.1.1 Duties ← ORRC

The word “duties” which is located directly prior to ORRC informs the meaning of ORRC. “Duties and other restrictive regulations of commerce...are eliminated with respect to substantially all the trade”.⁷⁵ The word other connects duties to restrictive regulations of commerce, as to mean that “restrictive regulations” and “duties” belong to the same category, namely “restrictive regulations of commerce”. In this perspective it would be more correct to refer to “RRC” instead of “ORRC”, hence, the word “other” in ORRC has no *raison d’être* in “ORRC”, since ORRC does not contain any reference to what “other” is supposed to be related to. Consequently, RRC or DAORRC would be less confusing terms according to this author. However, for the sake of simplicity the original abbreviations i.e. ORRC and ORC will be used hereinafter.

Two characteristics can be attached to the expression “duties” First, duties are *per se* restrictive regulations of commerce. The main purpose of duties are to restrict import of foreign goods for the purpose of protecting domestic producers; duties are therefore *per se* restrictive. Second, duties are classified as “border measures”, i.e. measures applied on products in connection with the passage of a border. Duties being *per se* restrictive border measures, informs the meaning of ORRC, suggesting that ORRC is the same type of restrictive regulations as duties. Meaning that, on the basis of comparison between duties and ORRC the conclusion would be that ORRC are *per se*

⁷⁵ Article XXIV:8(a)(i) GATT 1994

restrictive regulations of commerce applied to goods upon border crossing, (*see 11.1.2.1 Border Measures*).

11.1.2 ORRC→ The bracketed List of Exceptions⁷⁶

Incorporated between duties/ORRC and SAT the bracketed list of exceptions informs ORRC but also duties.

“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”⁷⁷

From the ordinary meaning of the words and expressions, and their placing in the paragraph, it seems reasonable to conclude that the articles listed in the bracketed list of exceptions are *de facto* ORRCs and/or duties. This is due to the existence of the word except, which insinuates that article XI-XV and XX are duties and/or ORRCs yet, exempted from the requirement of elimination. Consequently, articles in the bracketed list of exceptions are ORRCs, duties or a combination of duties and ORRCs which may be retained in respect to the SAT part of trade.

An analysis of the excepted provisions may provide information on what types of regulations that, according to the actual text of paragraph 8, are encompassed by the term ORRC. The line of reasoning is that article XI-XV and XX are ORRCs, however exempted from elimination, and their tenor provides an indication of what type of regulations that, on the contrary, must be eliminated.

XI General Elimination of Quantitative Restrictions

Prohibits quotas and other restrictions on imports and exports other than duties and charges, except for certain import and export restrictions in the agricultural sector, such as those to support domestic supply management regimes.

XII Restrictions to Safeguard the Balance of Payments

Permits import restrictions in the event of balance of payments emergencies

⁷⁶ *The bracketed list of exceptions is further analyzed in 11.2*

⁷⁷ *Article XXIV:8(a)(i) GATT 1994*

XIII Non-Discriminatory Administration of Quantitative Restrictions

Requires that in those areas where quotas are allowed (for instance, agriculture) quotas be applied on a non-discriminatory basis.

XIV Exceptions to the Rule of Non-discrimination

Allows deviation from the non-discriminatory application of quotas under article XIII if necessary for balance of payments reasons.

XV Exchange Arrangements

Allows deviation from GATT rules to comply with commitments to the International Monetary Fund.

XX General Exceptions

Allows qualified deviation from GATT rules for measures to protect health, safety, the environment.⁷⁸

The listed provisions cover both duties and quantitative (Article XI-XV) restrictions, these provisions can be labeled as border measures, i.e. measures such as duties and quotas, which have the sole purpose of restricting market access on imported goods, and as a consequence benefiting internally produced goods (discriminatory). However the list also includes Article XX which is a General Exceptions Clause, this clause justifies exceptions from all sorts of discriminatory measures, i.e. border measures in the form of quantitative restrictions, duties and discriminatory Technical Barriers to Trade and Sanitary and Phytosanitary measures (TBT/SPS). Measures under XX are allowed if such measures are necessary to protect human, animal or plant life or health, public morals etc.⁷⁹

Since the listed articles are ORRCs they provide an indication of the type of measure that must be eliminated, i.e. measures that are encompassed by ORRC. As a result it is possible to conclude that quantitative restrictions are encompassed by ORRC, since

⁷⁸ *Comments to each article from; Hudec Robert E. and Southwick James D. "Regionalism and WTO Rules: Problems in the Fine Art of Discriminating Fairly" in Rodriguez Mendoza, Miguel, Low, Patrick & Kotschwar, Barbara, "Trade Rules in the Making; Challenges in Regional and Multilateral Negotiations", General Secretariat/Organization of American States, Brookings Institution Press, Washington D.C, 2003, p 63*

⁷⁹ *It is hard to construe a situation where a discriminatory TBT/SPS measure could be utilized under Article XX, nevertheless, because Article XX reads; unless the measure is "unjustifiable... nothing in this agreement shall be construed to prevent..." the author has left a door open for just about any measure necessary, including discriminatory TBT/SPS measures.*

Article XI, XII, XII, XIV and XV all deal with quantitative restrictions. Article XX on the contrary deals with any type of restrictions which has the purpose of protection of human life etc. If the same conclusion would be suggested with regards to Article XX as to XI-XV it would mean that ORRC encompasses all possible restrictive regulations of commerce that can be justified under Article XX.⁸⁰ As concluded above, this would mean that even TBT/SPS measures would have to be eliminated on the intra-regional trade in a RTA for the RTA to qualify as a CU or FTA under paragraph 8.

However, the presence of Article XX in the bracketed list of exceptions does not necessarily mean that measures covered by XX, must, *a'contrario*, be encompassed by ORRC. Instead, the inclusion of Article XX may only mean that measures applied under the XX conditions, for the protection of human life etc. are exempted from the elimination in respect to SAT.⁸¹ Furthermore, an *a'contrario* conclusion of Article XX in this case would render absurd consequences. If ORRC would encompass all restrictive regulations, e.g. TBT/SPS measures, a FTA-formation would become a impossibility. If a FTA would actually be required, pursuant to paragraph 8(b) to eliminate substantially all TBT/SPS measures on the intra-regional trade, they would in effect, no longer be a FTA, instead the FTA would become a CU because a CU is required to establish a common external trade regime in paragraph 8(a)(ii), however a FTA is not.⁸² Moreover, if ORRC would encompass TBT/SPS measures, paragraph 8(a)(ii) would be redundant.

This argument is also raised by Trachtman in his paper on TBT/SPS measures in relation to Article XXIV;

⁸⁰ *Unless the restrictive regulation is necessary (list of exceptions), and justified under Article XX and therefore are exempted from the elimination criterion.*

⁸¹ **Gobbi Estrella, Angela T. & Horlick, Gary N.** "Regional Trade Agreements and the WTO Legal System, Mandatory Abolition of Anti-Dumping, Countervailing Duties and Safeguards in Customs Unions and Free Trade Areas Constituted between WTO Members: Revisiting a Long-standing Discussion in Light of the Appellate Body's Turkey-textiles Ruling" in **Bartels, Lorand & Ortino, Federico**, "Regional Trade Agreements and the WTO Legal System", Oxford University Press, 2006, p 121

⁸² *The complete elimination of all potentially restrictive regulations of commerce is something that not even the most developed CU, i.e. The EC, has accomplished. In fact, complete elimination of all potentially restrictive regulations of commerce, is not even possible to accomplish within a single customs territory, i.e. a country, due to geographical circumstances.*

*“it would be absurd to include all TBT/SPS measures as ORRCs, because the implication would be that Article XXIV:8(a)(i) and XXIV:8(b) require their elimination. It must be that if any TBT/SPS measures are included, it is a subcategory of them. This would seem to support interpretation that only discriminatory, or perhaps also unnecessary, TBT/SPS measures are ORRCs”.*⁸³

This point of view is certainly reasonable, and it would lead to an interpretation of ORRC as covering regulations of commerce which are, a) border measures, (duties, quotas. etc) or, b) discriminatory and/or unnecessary internal measures. In fact, when internal measures are applied in a discriminatory or unnecessary manner, they are supposedly transformed into border measures. The difference between border measures and internal measures would be that border measures are presumed as constituting ORRCs. Meanwhile internal measures must display additional characteristics to qualify as ORRCs. Internal measures are therefore by default, not ORRCs, unless the additional characteristics are provided for.

The above conclusion answers the most frequently debated subject, i.e.; whether ORRC encompasses Antidumping and Countervailing Duties (Article VI) and Safeguard measures (XIX). Since those articles are not listed as exceptions, and are applied in the form of quotas or duties, they are *per se* border measures and are as a consequence certainly encompassed by ORRC and shall therefore be eliminated in respect to SAT.

In this context it is important to establish a demarcation line between border measures and internal measures. It has been suggested that border measures are *per se* ORRCs, and that internal measures might be encompassed by ORRC. It is a known fact that it is hard to draw a line between *per se* border measures such as duties or quantitative restrictions and internal measures that takes the form of border measures, which in fact most of them do.⁸⁴

⁸³ **Trachtman Joel P.** “Toward Open Recognition? Standardization and Regional Integration Under Article XXIV of GATT”, Tufts University, Medford, Massachusetts, USA, 2002, p26, http://www.wto.org/english/tratop_e/region_e/sem_april02_e/joel_trachtman.pdf

⁸⁴ **Van Den Bossche, Peter** “The Law and Policy of the World Trade Organization”, Cambridge University Press, 2005, p 329

11.1.2.1 Border measures

Border measures are the equivalent of discriminatory measures, for example duties and quantitative restrictions (quotas) which are the most common. Duties and quotas are applied to imported goods but not to domestically produced goods, therefore they are discriminatory. The purpose of duties and quotas is restriction of market access on externally produced goods, affording domestic industries a competitive advantage. Duties and quotas are consequently protectionist tools. Duties are nevertheless permitted under GATT, as long as they are applied on an MFN basis. Quantitative restrictions are as a general rule prohibited in Article XI, but there are many exceptions to that rule, e.g. in Article XI:2.

11.1.2.2 Internal Measures

The characteristics of internal measures are that they do not have a protectionist purpose, and they are non-discriminatory, meaning that the same rules apply to domestic products as to foreign products. Most commonly, internal rules relate to public safety and health, for example rules that requires from food producers to have a certain standard when producing dairy products, or for a certain type of machine to be construed in a way that prevents personal injury, etc. These regulations are generally permitted under Article III of GATT 1994, (National Treatment), under the condition that they are not discriminatory applied. However, in recent years it has been discovered that such regulations may be misused, so that they are used to in fact protect domestic industry, i.e. they are discriminatory or unnecessary. This mischief may be very difficult to detect and many of the internal measures which are in compliance with the rule of Article III, National Treatment, are applied at the border, just as discriminatory border measures. For example; customs authorities may open packages in order to inspect certain items conformity to national health and safety regulations.⁸⁵ A relevant question is at what point does an internal measure become a border measure?

Ad Article III note. clarifies the distinction between border measures as for example in Article XI and internal measures as in Article III.

⁸⁵ *Van Den Bossche, Peter* "The Law and Policy of the World Trade Organization", Cambridge University Press, 2005, p 329

“Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III.”⁸⁶

This means that an internal measure stays an internal measure as long as it is not discriminatory (*see emphasis*), when it is discriminatory applied it transforms into a border measure.⁸⁷ A borderline case is when an internal measure is unnecessary but not discriminatory. For example, if domestic industry is prepared for a certain unnecessary technical regulation which will be required from a certain point in time, meanwhile foreign producers of the same product are not aware of the alteration of regulations. If a country would decide that only green cars are allowed to be marketed domestically (unnecessary, but not discriminatory, since the same rule applies to both domestic and foreign producers), domestic car manufacturers would receive an early notice and only produce green cars, meanwhile foreign producers would not receive early notice. During the period required for the foreign producers to convert their production to green cars, the domestic producers would enjoy a situation reminding of monopoly. In this way protection can be afforded to domestic producers without any application of discriminatory/illegal regulations.

Conclusively, on the basis of a comparison between ORRC and the list of exceptions, ORRC encompasses border measures, which includes discriminatory and perhaps unnecessary internal measures. It is hard to conclude whether unnecessary TBT/SPS measures are encompassed by ORRC, albeit, such measures certainly fall within the purpose of the rule of elimination of ORRCs they do not necessarily fall within the ordinary meaning of the text.

⁸⁶ *Ad Article III note. (Emphasis added)*

⁸⁷ **Van Den Bossche, Peter** “*The Law and Policy of the World Trade Organization*”, Cambridge University Press, 2005, p 329

11.1.3 ORRC and ORC

The expression “other regulations of commerce” (ORC) can be found in paragraph 5 and in paragraph 8(a)(ii). The conception of ORC is of interest in its capacity of being similar to ORRC; it is common practice to compare ORC to ORRC in order to find a definition on ORRC. The actual wording suggests that ORC has a wider scope than ORRC; a reason for this interpretation is also the Turkey-Textiles Panel report, in which a definition on ORC was delivered. The Panel declared, regarding paragraph 5, that;

“While there is no agreed definition between Members as to the scope of this concept of "other regulations of commerce", for our purposes, it is clear that this concept includes quantitative restrictions. More broadly, the ordinary meaning of the terms "other regulations of commerce" could be understood to include any regulation having an impact on trade (such as measures in the fields covered by WTO rules, e.g. sanitary and phytosanitary, customs valuation, anti-dumping, technical barriers to trade; as well as any other trade-related domestic regulation, e.g. environmental standards, export credit schemes). Given the dynamic nature of regional trade agreements, we consider that this is an evolving concept.”⁸⁸

The fact that the Panel provides a definition of ORC as being “any regulation having an impact on trade” is *de facto* less interesting than the information on which measures that are encompassed by ORC. That is, “WTO rules, e.g. sanitary and phytosanitary, customs valuation, anti-dumping, technical barriers to trade; as well as any other trade-related domestic regulation, e.g. environmental standards, export credit schemes”. Based on the Panels definition of ORC, the definition of ORRC would be “any [restrictive] regulation having an impact on trade”.⁸⁹ That would not

⁸⁸ Turkey-Textiles Panel Report, WT/DS34/R, paragraph 9.120. The statement was not rebutted by the Appellate Body, WT/DS34/AB/R

⁸⁹ **Gobbi Estrella, Angela T. & Horlick, Gary N.** “Regional Trade Agreements and the WTO Legal System, Mandatory Abolition of Anti-Dumping, Countervailing Duties and Safeguards in Customs Unions and Free Trade Areas Constituted between WTO Members: Revisiting a Long-standing Discussion in Light of the Appellate Body’s Turkey-textiles Ruling” in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 119

upset the definition of ORRC as much as the definition of ORC, basically any measure having an impact on trade, positive or negative, are supposed to, not become more restrictive (or higher). This is obviously a misinterpretation on behalf of the Panel. What they forgot to mention is that the rules having an impact on trade must be rules that, *per se*, has a restrictive impact on trade, i.e. border measures and not internal measures. Moreover, this interpretation can be read out of the paragraph directly.

*“with respect to a customs union, or an interim agreement leading to a formation of a customs union, the **duties** and **other regulations of commerce** imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be **higher** or **more restrictive** than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;”*⁹⁰

Obviously, the word “higher” refers to “duties”, meanwhile the words “more restrictive” refers to “other regulations of commerce”, it would be a peculiar choice of words to refer to duties as being more restrictive, since duties are *per se* restrictive (border measures).⁹¹ It would also be a strange drafting technique to call for “other regulations of commerce” to not become “more restrictive” unless they actually were restrictive to begin with.⁹²

Trachtman goes even further, he concludes that the expression and abbreviation ORC, exists as a result of the principle of effective interpretation, i.e. ORC and ORRC ought to have different meanings because they have different wordings. Sticking to that line of reasoning, he concludes,

⁹⁰ Article XXIV GATT 1994, paragraph 5(a), the similar wording is found in paragraph 5(b) regarding Free trade areas and interim agreements to free trade areas

⁹¹ The fact that “more restrictive” refers to ORC and that “higher” refers to duties was confirmed by the Appellate Body in the Turkey-Textiles Appellate Body Report, WT/DS34/AB/R, paragraph 53,54

⁹² **Trachtman Joel P.** *Toward Open Recognition? Standardization and Regional Integration Under Article XXIV of GATT*, Tufts University, Medford, Massachusetts, USA, 2002, p 25
http://www.wto.org/english/tratop_e/region_e/sem_april02_e/joel_trachtman.pdf

“...as regulations cannot grammatically be “higher”, the only obligation under this provision with respect to ORC is to ensure that they are not “more restrictive”. Therefore, the only ORCs actually addressed are those that are “restrictive””.

*“One supposes that the expressio unius principle of interpretation could be deployed to argue that ORCs do not [even] include restrictive regulations, but this would assume great incompetence on the part of the draftsman, and would seem contrary to the intent of at least Article XXIV:5”.*⁹³

Consequently, this author is of the opinion that ORC in paragraph 5 has exactly the same meaning as ORRC, meaning that ORC in paragraph 5 is really ORRC, not the opposite.⁹⁴ The expression ORC therefore has little or no inherent influence on the interpretation of ORRC in paragraph 8 other than the fact that the two expressions share the same purport. Consequently, ORC in paragraph 5 does not change the previous conclusion on ORRC as referring to border measures. This is an interpretation that is applicable in paragraph 5 as well as in paragraph 8 as described above. It seems reasonable that paragraph 5 is stating that any pre existing border measures, or for that matter, non existing border measures shall not become more restrictive after the formation of the RTA than prior to the formation. Meaning that no new border measures can be imposed as an effect of the RTA formation and duties cannot be raised as an effect of the RTA formation, in fact, what is required is a status quo regarding border measures. This interpretation is also in accordance with the purpose of Article XXIV; as for a RTA to facilitate trade internally and not to raise barriers externally.⁹⁵

11.1.3.1 ORC in paragraph 8(a)(ii)

Paragraph 8(a)(ii) is generally interpreted as requiring of a CU to establish a common external trade regime. In fact, 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. The same requirement is observed in paragraph 8(a)(i) regarding CUs, however, there is a difference; in paragraph 8(a)(i) the elimination of

⁹³ **Trachtman Joel P.** *Toward Open Recognition? Standardization and Regional Integration Under Article XXIV of GATT*, Tufts University, Medford, Massachusetts, USA, 2002, p 24
http://www.wto.org/english/tratop_e/region_e/sem_april02_e/joel_trachtman.pdf [emphasis added]

⁹⁴ *Since other regulations of commerce (ORC) refers to restrictive the correct reading should be other (restrictive) regulations of commerce, i.e. ORRC, this means that ORC is fictitious in paragraph 5, and should therefore not be described as ORC, but instead ORRC.*

⁹⁵ *Article XXIV:4 GATT 1994*

ORRCs is required and in paragraph 8(a)(ii) the elimination of ORCs is required (*a'contrario*).

In paragraph 8(a)(ii) the expression other regulations of commerce are completely detached from the “restrictive” requisite, since it is not at all found in the paragraph. On a textual basis the absence of “restrictive” in the paragraph clearly indicates that the phrase other regulations of commerce in paragraph 8(a)(ii) is meant to distinguish itself from the similar ORRC concept found in 8(a)(i), 8(b) and according to this author, 5(a, b).

Considering that 8(a)(ii) only targets CUs, it can, on good grounds be assumed that the provision is supposed to mean something different than the ORRC concept in provisions targeting both FTAs and CUs. This assumption is well-founded because of the inherently different character of CUs and FTAs. These facts strengthens the assumption that ORC in paragraph 8(a)(ii) is not the same as ORRC in 5(a,b), 8(a)(i) and 8(b).

This suggests that ORC in the meaning 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 TBT/SPS measures and/or measures covered by GATT Article III (national treatment). This is also 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. Since substantially all duties and ORRCs 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), *a'contrario*, requires the elimination of TBT/SPS measures internally, i.e. harmonization of internal trade regulations in addition to elimination of duties and ORRCs pursuant to 8(a)(i).

11.2 Meaning of the Bracketed List of Exceptions

Paragraph 8 in general and the bracketed list of exceptions in particular, are provisions which are open for arbitrary interpretation; Contracting Parties to the WTO as well as individuals, are eager to, if possible, get something for nothing. As a

consequence the provisions of, especially, the bracketed list of exceptions has been abused time and again and this abuse will be analyzed in this chapter.

11.2.1 Circumvention of paragraph 8, imaginative interpretations on the list of exceptions

Paragraph 8 affords members to RTAs the benefit of MFN exception, so that RTA members may grant each other preferential trade regulations without having to apply those to the trade of remaining WTO-members. The price for this benefit is, among others, the elimination of ORRCs on the intra-regional trade. This requirement mainly strikes FTAs⁹⁶, because of their absence of a common external trade regime, which on the contrary is required from RTAs in the form of CUs.⁹⁷ Members to a CU have no reason, or should have no reason, to impose trade restrictions internally since members to a CU are all part of the same internal market, i.e. there are no internal trading-borders within a CU, it is therefore, under normal circumstances, neither possible, or sought for, to apply border measures to the intra-CU-trade. This discussion is therefore mainly concerning FTAs.

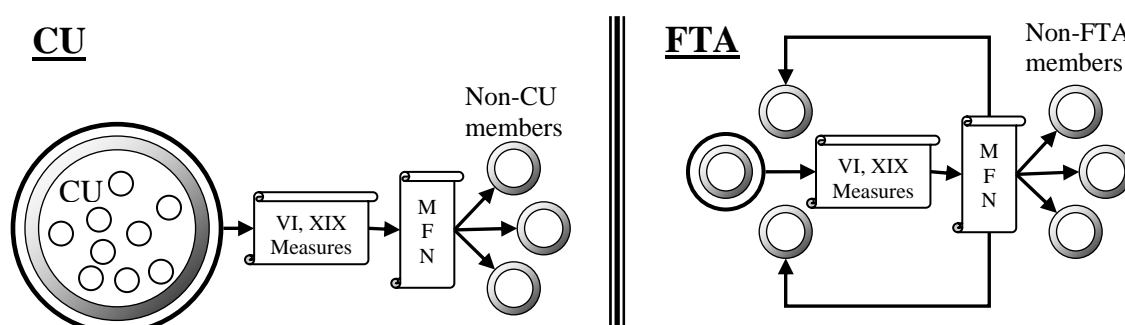


Figure 1: The figure illustrates the fundamental difference between a CU and a FTA, the black ring around the CU represents the common external trade border of a CU, in contrast a FTA has no common external trade border, in consequence a party to a RTA applying trade remedies to a non-FTA member is required under the provisions of GATT Article I (MFN) and the Agreement on Safeguards Article 2.2, to apply the same remedies to their fellow FTA partners. This renders application of trade remedies very difficult for FTAs.

Members to FTAs have constructed interpretational models of paragraph 8 to support them in their efforts of enjoying preferential treatment without having to give up their “rights” of employing trade remedies. “Trade remedies” is a generic term for measures applied with the purpose of correcting harmful trade flows, i.e. extreme

⁹⁶ Since the turn of the century 70 XXIV RTAs has entered into force out of the 70 RTAs 66 are Free Trade Areas and only 4 Customs Unions, http://www.wto.org/english/tratop_e/region_e/type_e.xls

⁹⁷ Article XXIV:8(a)(ii) GATT 1994

trade flows that threaten to harm a country's economy. These measures are regulated in article VI (Anti-dumping/countervailing duties) and XIX (Safeguard measures). As an effect of forming a FTA, members must eliminate substantially all ORRCs (which as shown, include VI and XIX measures, since those are border measures, applied as duties or quotas, *see 11.1.2*) on substantially all the intra-FTA trade.⁹⁸ Application of trade remedies according to VI and XIX requires MFN treatment,⁹⁹ which in this case means that when a FTA country wishes to apply trade remedies to a third party (non-FTA member) it must also apply the same measures to their fellow FTA partners. However, applying trade remedies to FTA partners are in principle not allowed according to XXIV: 8(b). Since VI and XIX are ORRCs which are not exempted, they must be eliminated in respect to substantially all the trade. This means that application of trade remedies on intra-FTA trade can only be permissible, at least in theory, to the extent that the insubstantial part of all trade allows.¹⁰⁰

11.2.1.1 Circumvention techniques, the must vs. may debate

The objective of these constructions are to enable a discriminatory application of trade remedies, meaning that one RTA member wants to apply trade remedies upon non-RTA members without having to apply the same remedies toward fellow RTA partners, i.e. in violation of MFN and the Agreement on Safeguards Article 2.2.¹⁰¹ For the sake of exemplifying, this is what happened in the US-Line Pipe case. The United States applied safeguard measures, regarding circular welded carbon quality line pipe, to non-NAFTA members, thus excluding NAFTA members Canada and Mexico from

⁹⁸ Article XXIV:8(a)(ii) GATT 1994

⁹⁹ Article I GATT 1994 and Article 2.2 in the Agreement on Safeguards. The footnote (1) to Article 2.2 in the Agreement on Safeguards allows for a customs union to apply safeguard measures as a single unit or on behalf of a cu-member. It reads; "A customs union may apply a safeguard measure as a single unit or on behalf of a member State. When a customs union applies a safeguard measure as a single unit, all the requirements for the determination of serious injury or threat thereof under this Agreement shall be based on the conditions existing in the customs union as a whole. When a safeguard measure is applied on behalf of a member State, all the requirements for the determination of serious injury or threat thereof shall be based on the conditions existing in that member State and the measure shall be limited to that member State. Nothing in this Agreement prejudices the interpretation of the relationship between Article XIX and paragraph 8 of Article XXIV of GATT 1994."

¹⁰⁰ *see the Turkey-Textiles Appellate Body Report, WT/DS34/AB/R, paragraph 48, where the Appellate Body opens for the theoretical possibility to apply trade measures even within a customs union.*

¹⁰¹ Article 2.2. In the Agreement on Safeguards reads; "Safeguard measures shall be applied to a product being imported irrespective of its source."

the same measures. The safeguard measure was applied in the form of higher duties, between 19 and 11 per cent per year during a three year period.¹⁰²

The Appellate body in the US-Line Pipe refused to present an answer to the question of whether a RTA member, according to Article XXIV, is required (must) or exempted (may, but do not have to) from MFN treatment and the Agreement on Safeguards obligation to impose trade remedies to RTA partners when applying such to non-RTA members. On the contrary, the Appellate Body explicitly stated in the US-Line Pipe case that their findings (when reversing the Panels findings) did not prejudice the question of whether Article XXIV permits deviation from Article 2.2 in the Agreement on Safeguards.¹⁰³ The similar reasoning was conveyed by the Appellate Body in the Argentina-Footwear case.¹⁰⁴ In both cases the Appellate Body reversed the Panels findings, by referring to lack of parallelism between the safeguard investigation and the safeguard application, instead of investigating whether or not Article XXIV constituted an exception from the non-discriminatory application of safeguards. By referring to the parallelism requirement, the Appellate Body freed themselves from having to go the “extra mile” and having to investigate the core question of the meaning of the bracketed list of exceptions.¹⁰⁵

¹⁰² *US-Line Pipe, Appellate Body Report, WT/DS202/AB/R, February 15, 2002, paragraph 6*

¹⁰³ *Ibid, at 198, “In doing so, we do not prejudice whether Article 2.2 of the Agreement on Safeguards permits a Member to exclude imports originating in member states of a free-trade area from the scope of a safeguard measure. We need not, and so do not, rule on the question whether Article XXIV of the GATT 1994 permits exempting imports originating in a partner of a free-trade area from a measure in departure from Article 2.2 of the Agreement on Safeguards. The question of whether Article XXIV of the GATT 1994 serves as an exception to Article 2.2 of the Agreement on Safeguards becomes relevant in only two possible circumstances. One is when, in the investigation by the competent authorities of a WTO Member, the imports that are exempted from the safeguard measure are not considered in the determination of serious injury. The other is when, in such an investigation, the imports that are exempted from the safeguard measure are considered in the determination of serious injury, and the competent authorities have also established explicitly, through a reasoned and adequate explanation, that imports from sources outside the free-trade area, alone, satisfied the conditions for the application of a safeguard measure, as set out in Article 2.1 and elaborated in Article 4.2“*

¹⁰⁴ *Argentina-Footwear Appellate Body Report, WT/DS121/AB/R, paragraph 151(d)*

¹⁰⁵ *In the Argentina-Footwear case, paragraph 13, Argentina actually claimed that footnote 1 to Article 2.1. in the Agreement on Safeguards, explicitly allowed a member of a customs union to apply safeguards measures to third countries and exempting CU partners. However, since Argentina alone applied the safeguards, as opposed to MERCOSUR (An alleged Latin American Customs Union in which Argentina is one of the member-states) the Appellate Body never tried the question on a Customs Union basis. “MERCOSUR did not apply these safeguard measures, either as a single unit or on behalf of Argentina.” see paragraph 107. The Appellate Body concluded; “Therefore, at the time the safeguard measures at issue in this case were imposed by the Government of Argentina, these measures were not applied by MERCOSUR “on behalf of” Argentina, but rather, they were applied by Argentina. It is Argentina that is a Member of the WTO for the purposes of Article 2 of the Agreement*

11.2.1.1.1 The must-may interpretation of the bracketed list of exceptions

This solution relies on an *a'contrario* conclusion of the exceptions list. First, the articles listed in the bracketed exceptions list (XI-XV, XX) are interpreted as to be measures that must be applied on an MFN basis, *a'contrario*; articles not listed *may* (but do not have to) be applied on an MFN basis, meaning that FTA members do not have to apply trade remedies to fellow FTA partners. This interpretation was asserted by the EC in the 1973 FTA between EC and Sweden, the EC representative argued that;

*“The omission of Article XIX from among those mentioned in Article XXIV:8(b), which required the elimination of certain “other restrictive regulations of commerce” as between members of the free-trade area. His authorities, accordingly, were of the view that they were free to exempt these members from possible restrictions imposed under Article XIX”.*¹⁰⁶

Consequently, the reading of paragraph 8(b) would be; “duties and other restrictive regulations of commerce [*are eliminated from MFN treatment*] (except, where necessary, those permitted under Articles XI, XII, XII, XIV, XV and XX) on substantially all the trade between the constituent territories...”. This reading is clearly inconsistent with VCLT Article 31(1) for the reason that to be able to arrive at the above conclusion one must add words and relocate certain phrases, which means that the interpretation clearly distorts the ordinary meaning of the words.¹⁰⁷

on Safeguards, and it was Argentina that applied the safeguard measures after conducting an investigation of products being imported into its territory and the effects of those imports on its domestic industry. For these reasons, we do not believe that footnote 1 to Article 2.1 applies to the safeguard measures imposed by Argentina in this case.” Ibid, at 108.

¹⁰⁶ Working Party Report EC-Sweden, November 13, 1973, L/3899, Paragraph 33

¹⁰⁷ **Gobbi Estrella, Angela T. & Horlick, Gary N.** “Regional Trade Agreements and the WTO Legal System, Mandatory Abolition of Anti-Dumping, Countervailing Duties and Safeguards in Customs Unions and Free Trade Areas Constituted between WTO Members: Revisiting a Long-standing Discussion in Light of the Appellate Body’s Turkey-textiles Ruling” in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 126

11.2.1.1.2 The may-may interpretation of the bracketed list of exceptions - the non-exhaustive character of the exceptions list

This interpretation is less intricate; it is simply based on the assumption that the bracketed list of exceptions is merely illustrative as opposed to exhaustive. The effect of a non-exhaustive exceptions list is that the listed provisions *may* (but do not have to) be applied to RTA partners and that the provisions not listed also *may* (but do not have to) be applied to RTA partners. This interpretation leads to the conclusion that any and all ORRCs (including trade remedies VI, XIX) *may* be excepted from the elimination of ORRCs in respect to substantially all the trade, and consequently, trade remedies *must not* be applied to RTA partners. However, a common indication of a non-exhaustive listing in any legal text is the inclusion of the words “such as”, and the reading of the exceptions list would in that case be; “except, where necessary, [*such as*], those permitted under Articles XI, XII, XIII, XIV, XV and XX”.¹⁰⁸ Since the actual phrasing does not include “such as” it cannot be interpreted as being non exhaustive according to VCLT. However, it has been asserted that the exceptions list cannot be exhaustive because of the fact that Article XXI on security exceptions is omitted from the exceptions listing. The line of reasoning is that, if any article should be excepted from elimination it should be XXI which provides the Contracting Parties with a possibility to deviate from any provision in the GATT if necessary for the protection of their essential security interests.

*“It would be difficult, however, to dispute the right of contracting parties to avail themselves of that provision [XXI] which related, inter alia, to traffic in arms, fissionable materials, etc., and it must therefore be concluded that the list was not exhaustive”.*¹⁰⁹

Even if that suggestion is hard to contest, it leads to absurd consequences since it renders the whole exceptions list meaningless, and is therefore, most certainly an

¹⁰⁸ **Gobbi Estrella, Angela T. & Horlick, Gary N.** “Regional Trade Agreements and the WTO Legal System, Mandatory Abolition of Anti-Dumping, Countervailing Duties and Safeguards in Customs Unions and Free Trade Areas Constituted between WTO Members: Revisiting a Long-standing Discussion in Light of the Appellate Body’s Turkey-textiles Ruling” in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 135

¹⁰⁹ Argued by the EEC, see Sub-group D of the Committee on the Treaty of Rome, GATT Doc. L/778, November 29 1957, p 27, paragraph 26.

incorrect interpretation.¹¹⁰ In addition, a reasonable explanation for the non-inclusion of Article XXI in the exceptions list is revealed when examining the drafting history of paragraph 8. The original drafting of Article XXIV descends from the original ITO charter.¹¹¹ The ITO charter had a chapter structure which differed from that which is found in GATT as of today. The Article corresponding to Article XXI was at that time located in a chapter which contained general provisions to the ITO that, accordingly, were supposed to be applied to the whole ITO charter.¹¹² When the ITO charter was modified, due to the relinquished formation of an International Trade Organization, the drafters were of the opinion that retaining the original articles preamble, which stated that; “nothing in this charter [agreement] shall be construed...” would be adequate to sufficiently illustrate that the provision was intended to apply to all parts of the new “General Agreement on Tariffs and Trade”.¹¹³

11.2.1.1.3 The may-must interpretation of the bracketed list of exceptions

This interpretation relies on the highly probable assumption that the exceptions list is exhaustive, since nothing in the wording suggests that it would not be. Meaning that the listed provisions *may* be applied to FTA partners, and that provisions not listed, *a’ contrario*, *must* be applied to FTA partners in respect to substantially all the trade. This is the only interpretation which can be justified under VCLT, XXIV:4 and the Understanding on Article XXIV, as described above.

Consequently, the correct interpretation of the bracketed exceptions list according to this Author is:

1. The articles listed (i.e. XI, XII, XIII, XIV, XV) may, where necessary be kept in place in the intra-regional trade without detracting from the substantially all the trade requisite.

¹¹⁰ **Gobbi Estrella, Angela T. & Horlick, Gary N.** “Regional Trade Agreements and the WTO Legal System, Mandatory Abolition of Anti-Dumping, Countervailing Duties and Safeguards in Customs Unions and Free Trade Areas Constituted between WTO Members: Revisiting a Long-standing Discussion in Light of the Appellate Body’s Turkey-textiles Ruling” in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 135

¹¹¹ **Mathis, James H.** “Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement”, Asser Press, the Netherlands, 2002, p 62-63

¹¹² *Ibid*

¹¹³ *Ibid*

2. The articles not listed, e.g. VI and XIX must be eliminated regarding substantially all the intra-RTA trade, any remaining VI and XIX regulations detracts from the SAT requisite, i.e. the part of intra-RTA trade affected by trade remedies may not exceed approximately 5-10% of all intra-RTA-trade. (See 11.3 for the 5-10% criterion)

11.3 Meaning of...eliminated with respect to substantially all the trade

The phrase “eliminated with respect to substantially all the trade” consists of two requisites, the first being “eliminated”, the second, “substantially all the trade” (SAT). SAT has been treated by the Appellate Body in the Turkey-textiles case and the term “eliminated” has been discussed in various forums, and is actually not really open for “creative” interpretation. Consequently, the interpretation of those requisites can be found in a standard dictionary, WTO-communication and case law. The real difficulties, however, lies in defining the methods of calculating “all the trade” and determining whether all trade-sectors must be encompassed by the elimination or if entire trade-sectors can be left out from liberalization as long as the SAT benchmark is met? The most commonly “left out” trade sector is agricultural products; it has been much debated whether Article XXIV can be interpreted in such a way as to exclude an entire sector of trade from liberalization.

Looking at the textual meaning, “eliminated” cannot be misinterpreted, it means; to remove or take out; get rid of.¹¹⁴ Consequently, duties and other restrictive regulations of commerce... are to *be removed, taken out or gotten rid of*, on substantially all the trade between the constituent territories. The more complicated interpretation is that of the “substantially all the trade”. Two questions arises; how much is “substantially all the trade” and how is it supposed to be measured? Different standards measured in percentage of all intra-regional trade have been suggested over the years, 80%¹¹⁵, 90%¹¹⁶ and finally 95% which was proposed by Australia during the Doha round of

¹¹⁴ Wordfinder, Collins English Dictionary.

¹¹⁵ **Whalley John**, "Recent Regional Agreements: Why So Many, So Fast, So Different and Where Are They Headed?" (September 2006). CIGI Working Paper No. 9 Available at SSRN: <http://ssrn.com/abstract=941445> p 25. "In 1947, regional agreements were only minimally discussed in the negotiation of the GATT Articles. Article 24 permitted members to participate in regional agreements under the two conditions: 1) that all trade between parties would be covered (usually interpreted as covering at least 80% of trade"

¹¹⁶ **Matsushita, Mitsuo & Ahn, Dukguen** "WTO and East Asia: New Perspectives", Cameron May International Law & Policy, London, 2004, p 504

negotiations.¹¹⁷ Moreover, the Turkey-Textiles panel presented a definition of “substantially all” which was not rebutted by the Appellate Body, however that definition did not provide any further clarification to that of a possible benchmark for SAT.

“Neither the GATT CONTRACTING PARTIES nor the WTO Members have ever reached an agreement on the interpretation of the term "substantially" in this provision. 14 It is clear, though, 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.”¹¹⁸

The Turkey-Textile Panel merely concluded what everybody already knew; “substantially all”, is certainly more than 50% and a little bit less than 100%. It seems fairly safe to conclude that in a quantitative approach the limit dividing the “substantially all”-part of trade from the insubstantial part of all trade would be in the vicinity of 80-95%. However, regardless of whether the benchmark is 80% or 95% it is still an enigma, how to calculate “all the trade” as well as “substantially all the trade”. Under any circumstance, a benchmark would not be worth more than the quality of the method with which the benchmark is calculated. Consequently, a threshold at, for example, 95% would not, alone, solve the problem. Most observers agree that “substantially all the trade” must be calculated from both a quantitative approach as well as a qualitative approach.¹¹⁹ Furthermore, that point of view was also presented by the Turkey-Textiles Panel and not rebutted by the Appellate Body;

“We agree with the Panel that: [t]he ordinary meaning of the term "substantially" in the context of subparagraph 8(a)

¹¹⁷ *Negotiating Group on Rules, May 12, 2005, Submission on Regional Trade Agreements by Australia, TN/RL/W/180 (May 13, 2005), paragraph 4* “Australia proposed a definition of ‘substantially all trade’ as eliminating all duties on a minimum of 95 percent of tariff lines at the six digit level of the Harmonized System (HS). While the figure has been described as ‘ambitious’, we firmly believe it is necessary to ensure the integrity of the multilateral trading system”

¹¹⁸ *Turkey-Textiles, Appellate Body Report, WT/DS34/AB/R22 October 1999, paragraph 48*

¹¹⁹ For example, **Lockhart, Nicolas JS, & Mitchell, Andrew David**, “Regional Trade Agreements under GATT 1994: An Exception and its Limits” in **Mitchell, Andrew David**, “Challenges and Prospects for the WTO”, *Cameron May International Law & Policy*, London, 2005, <http://www.worldtradelaw.net/articles/lockhartmitchellrta.pdf>, p 233. And **Cottier, Thomas & Foltea, Marina**, “Constitutional Functions of the WTO and Regional Trade Agreements” in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, *Oxford University Press*, 2006, p 48. And *Negotiating Group on Rules, May 12, 2005, Submission on Regional Trade Agreements by Australia, TN/RL/W/180 (May 13, 2005), paragraph 4*

appears to provide for both qualitative and quantitative components. The expression "substantially the same duties and other regulations of commerce are applied by each of the Members of the [customs] union" would appear to encompass both quantitative and qualitative elements, the quantitative aspect more emphasized in relation to duties".¹²⁰

Consequently, the fulfillment of the "substantially all the trade" criterion shall be measured from a quantitative, as well as a qualitative approach. This indicates that when an entire trade sector such as agricultural products are excluded from liberalization the qualitative benchmark would not be met, however, as described above, no threshold, which would function as an indication of fulfillment of the requisite, has ever been established.¹²¹ Nevertheless, Australia has proposed a well founded benchmark of 95% coverage of tariff lines at the six digit level of the Harmonized System (HS).¹²²

"To satisfy the proposed definition of 'substantially all trade', all duties and tariff rate quotas (TRQs) on tariff lines at a higher level of disaggregation (i.e. 8 and 10 digit levels) that are constituent parts of a six digit line must be eliminated if that six digit line is to be considered part of the 70 percent on entry into force or 95 percent after 10 years."¹²³

However, a benchmark concentrating only on tariff lines may be very misleading, due to the fact that some countries economies are concentrated to very few commodities.

¹²⁰ *Turkey-Textiles, Appellate Body Report, WT/DS34/AB/R22 October 1999, paragraph 49*

¹²¹ *A qualitative benchmark for the fulfillment of SAT is, by nature, a case by case judgment, this has been confirmed also by, for example EC, "any qualitative assessment of RTAs would by necessity have to be made on a case by case basis. Therefore, when a given RTA meets a future quantitative benchmark, this would constitute an element of greater security as to whether the agreements conforms to GATT Article XXIV, but would not constitute an automatic guarantee of conformity, as the other elements above will also have to be weighted". Negotiating Group on Rules, May 101, 2005, Submission on Regional Trade Agreements by the European Communities, TN/RL/W/179 (May 12, 2005), paragraph 10*

¹²² *(HS) The Harmonized Commodity Description and Coding System, entered into force June 14, 1998 and was developed by the former Customs Cooperation Council (CCC) today known as World Customs Organization (WCO). The Harmonized System consists of 21 sections covering 99 chapters, 1241 headings and over 5000 commodity groups. See, **Van Den Bossche, Peter** "The Law and Policy of the World Trade Organization", Cambridge University Press, 2005, p 426 and the WCO webpage; <http://www.wcoomd.org/home.htm>*

¹²³ *Negotiating Group on Rules, May 12, 2005, Submission on Regional Trade Agreements by Australia, TN/RL/W/180 (May 13, 2005), paragraph 11*

For example; as the Korean delegation argued at a session of the Committee on Regional Trade Agreements (CRTA) that the tariff line benchmark might lead to absurd results when;

*“a sizeable proportion of the trade in a particular agreement might lie in less than 5 per cent of the HS tariff lines. The four Faroe Islands agreements met that sort of condition, where well under 50 tariff lines accounted for about 80 per cent of the trade, so here the idea to base coverage on 95 per cent of HS tariff lines might not work”.*¹²⁴

With the above statement in mind it becomes evident that the tariff line benchmark alone does not solve the equation. Tariff lines are a good measurement when it comes to calculating the coverage of liberalization, however it does not ensure a quantitative coverage. The Australian proposal has identified this problem and accordingly presented a solution, the so called “Highly Traded Products Test” which has the purpose of ensuring that the most frequently traded commodities in each RTA are not left out of the intra-regional trade liberalization. Meaning that for a RTA to fulfill the SAT criterion, approximately; the 50 most traded products must be completely liberalized within a ten year period.¹²⁵ The Australian proposal consequently covers the quantitative as well as the qualitative parts of the “substantially all the trade” coverage required according to Article XXIV:8.¹²⁶ Australia’s efforts, are very much in line with the attempt to make RTAs a positive contribution to world trade

¹²⁴ *Negotiating Group on Rules, Submission on Regional Trade Agreements by Australia, TN/RL/W/180, May 13, 2005, paragraph 4. And The Committee on Regional Trade Agreements, Sixteenth Session, Note on the Meetings of 16-18 and 20 February 1998, (March 18 1998), p 35,*

¹²⁵ *“However, we recognize that a tariff line test alone may not capture ‘substantially all trade’ in all cases. Accordingly, we also proposed a “highly traded” product test. This test attempts to overcome the difficulties associated with a trade flow analysis (i.e. fluctuations in trade from year to year) by using as its base period the three years before entry into force of the agreement. Using this three year base period, we propose two options to define a “highly traded” product: (i) where the value of a Member’s imports in any single HS six digit line as a proportion of their total imports from the RTA partner exceeds 0.2 percent (this figure would be the average over the three year base period); or (ii) a requirement that the top, say 50, imports of each RTA party at the 6-digit level that are traded between the RTA partners must be included in the Agreement. Any product that is considered a “highly traded” product must be included in the agreement, i.e. duties must be eliminated on these products by the ten year transition period”. See; Negotiating Group on Rules, Submission on Regional Trade Agreements by Australia, TN/RL/W/180, May 13, 2005, paragraph 13-14*

¹²⁶ *A less, worked-out and less detailed but similar solution was also presented by the EC, the major concern brought up was the exclusion of agricultural products from intra-regional trade liberalization. See; Negotiation Group on Rules, Summary Report of the Meeting Held on 14 June 2005, TN/RL/29 (July 15, 2005)*

liberalization, and are also in accordance with the statement made in the Agreement on Article XXIV, where the contracting parties obviously agreed, that a high degree of elimination of trade restrictions within RTAs are vital.

“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;”¹²⁷

Australia’s suggestion would certainly sharpen the SAT-criterion, as to not enable an exclusion of entire trade sectors such agricultural products, however, strict regulations needs strict monitoring, a feature which has not been seen from the Committee on Regional Trade Agreements (CRTA) (*see chapter 13*). The work on finding solutions to these problems reveals an apparent sluggishness in the WTOs decision process and a lack of respect for, in fact, not so complicated rules, when interpreted in conformity with the purpose of GATT/WTO and VCLT. Nevertheless, it must be noticed that no agreement on the SAT subject has been reached so far, and that the lack of such an agreement actually is threatening to make an already confusing “spaghetti bowl” even more confusing.

11.3.1 What counts as elimination?

RTAs has the theoretical right to retain some ORRC on the intra-regional trade, i.e. the listed Articles in the bracketed list of exceptions and any other ORRC such as trade remedies on the insubstantial part of the trade. The decision to retain certain ORRCs in a RTA is most likely accompanied by a specific intra-RTA provision, authorizing certain trade measures in between the parties of the RTA. The question is if the “authorizing provision” as such, qualifies as an ORRC, although the measures it allows are not applied for the time being?

A textual analysis of the provision in the light of XXIV:4, The Understanding on the Interpretation of Article XXIV and the VCLT, provides only one possible interpretation. Again, paragraph 8 reads;

¹²⁷ *Preamble of the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994*

“duties and other restrictive regulations of commerce... are eliminated with respect to substantially all the trade”¹²⁸

Since other restrictive regulations of commerce and duties are to be eliminated, i.e. removed, taken out or gotten rid of, there cannot, consequently, be any restrictive regulations retained on the SAT part of intra-regional trade. Nevertheless, restrictive regulations can be maintained on the insubstantial part of trade. When such “authorizing provisions” are maintained, but not applied, the provision as such, cannot encompass trade in products that correlates to more than the insubstantial part of all trade. Of course monitoring such provisions will be virtually impossible; however, the monitoring must fall on the shoulders of other WTO members, and in the end, the DSU. This means that a RTA might fulfill the SAT criterion upon formation, but eventually, at a later stage they might not, i.e. if they have applied intra-regional trade measures which exceed the SAT benchmark. “Each party to an RTA assumes their own risk for dispute settlement if their agreement does not respect the SAT requirement at the moment they might need to invoke the Article XXIV defense”.¹²⁹ This means that each RTA can retain ORRCs on the insubstantial part of trade, however at their own risk. The effect of non fulfillment of SAT is that the RTA does not qualify as a FTA/CU in relation to paragraph 8, and as a consequence, MFN deviation is not permitted.

A way of challenging intra-RTA preferences is for a third country to question the RTA as an entity; if the RTA at the moment of the complainants attack, is shown to not fulfill the SAT criterion, the RTA as an entity is disqualified according to paragraph 8. It might be a risky business to not fully comply with the rules of RTA formation. But, as of today, most WTO-members are entangled in a myriad of RTAs, consequently, it would, possibly, be self incriminating to get involved in a dispute like that. In this respect the “Spaghetti Bowl” has become self sustaining.

However, one question remains unanswered; can a FTA/CU member really apply trade remedies upon a fellow RTA partner in respect to the insubstantial part of all internal trade? Nothing in paragraph 8 suggests otherwise. However, applying trade

¹²⁸ Article XXIV:8(a)(i) GATT 1994

¹²⁹ **Mathis, James H.** “Regional Trade Agreements and Domestic Regulation. What Reach for ‘Other Restrictive Regulations of Commerce in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 90

remedies to RTA partners would certainly be a contradiction; it might even be fair to assume that employing such measures internally would preclude the formation/existence of a RTA. Under all circumstances such a measure would rock the very foundation of RTAs in general and CUs in particular.¹³⁰ Nevertheless, the Turkey-Textiles Appellate Body report reveals that there is a certain degree of flexibility embedded into paragraph 8(a)(i), and that this flexibility is;

*“limited by the requirement that “duties and other restrictive regulations of commerce” be “eliminated with respect to substantially all” internal trade”.*¹³¹

This is an unambiguous indication on a possibility, even for members of a CU, to apply trade remedies to their intra-CU trade within the insubstantial part of trade. Nevertheless, this question must be considered unanswered for the time being.

11.4 XIV:8(a)(ii) Substantially the same duties and other regulations of commerce?

The meaning of ORC in paragraph 8(a)(ii) has been analyzed in chapter 11.1.3.1.

Paragraph 8(a)(ii) requires the parties to a CU to, internally apply “substantially the same duties and other regulations of commerce” to one another. Hence, the CU would not be a CU without a common and harmonized external trade regime. However, question has arisen on the meaning of “substantially the same”, since substantially in 8(a)(ii), clearly, does not have the same meaning as in 8(a)(i). This question was treated by the Turkey-Textiles panel and subsequently by the Appellate Body regarding the same case. The Panel ruled that:

“Considering this wide range of possibilities, we are of the view that, as a general rule, a situation where constituent members

¹³⁰ A similar argument was communicated by Australia to the CRTA, November 17, 1997, WT/REG/W/18, paragraph 21, “By concluding a customs union or a free trade agreement, the parties in effect agree to a measure of economic integration that goes beyond that promoted by their normal international economic relations. They seek to achieve efficiencies in the internal market that they see as being out of reach for the time through other means. It seems odd, therefore, that they should use Article XIX against each other in order to prevent these efficiencies. There is of course the possibility that the partners might agree on a transition period during which safeguard action is possible. But once the arrangement is in full effect, unforeseen circumstances should no longer be a factor under a free trade agreement. Accordingly, the use of Article XIX would then be redundant”.

¹³¹ Turkey-Textiles Appellate Body Report, WT/DS34/AB/R, paragraph 48

*have "comparable" trade regulations having similar effects with respect to the trade with third countries, would generally meet the qualitative dimension of the requirements of sub-paragraph 8(a)(ii). The possibility also exists of convergence across a very wide range of policy areas but with distinct exceptions in limited areas. The greater the degree of policy divergence, the lower the flexibility as to the areas in which this can occur; and vice-versa. In our view, our interpretation of sub-paragraph 8(a)(ii) allows Members to form a customs union, as in this case, where one constituent member is entitled to impose quantitative restrictions under a special transitional regime and the other constituent member is not"*¹³²

The Appellate body did partly agree and partly disagree with the Panel, stating that:

"We also believe that the Panel was correct in its statement that the terms of subparagraph 8(a)(ii), and, in particular, the phrase "substantially the same" offer a certain degree of "flexibility" to the constituent members of a customs union in "the creation of a common commercial policy." Here too we would caution that this "flexibility" is limited. It must not be forgotten that the word "substantially" qualifies the words "the same". Therefore, in our view, something closely approximating "sameness" is required by Article XXIV:8(a)(ii). We do not agree with the Panel that:

*... as a general rule, a situation where constituent members have "comparable" trade regulations having similar effects with respect to the trade with third countries, would generally meet the qualitative dimension of the requirements of sub-paragraph 8(a)(ii).*¹³³

¹³² Turkey-Textiles Panel Report, WT/DS34/R, paragraph 9.151.

¹³³ Turkey-Textiles Panel Report, WT/DS34/R, paragraph 9.151.

Sub-paragraph 8(a)(ii) requires the constituent members of a customs union to adopt "substantially the same" trade regulations. In our view, "comparable trade regulations having similar effects" do not meet this standard. A higher degree of "sameness" is required by the terms of sub-paragraph 8(a)(ii).¹³⁴

Conclusively, the requisite “substantially the same” is something closer to “same” than “comparably”. Albeit this statement is not very precise, it gives a suggestion to in which direction the Appellate Body intends XXIV exceptions to head, i.e. stricter interpretations on behalf of parties looking to make use of XXIV, especially CUs.

11.5 Rules of Origin

RoOs are a prerequisite for the establishment of a FTA. This is due to the fact that countries participating in a FTA maintain their separate tariff policies towards non-FTA members, i.e. the rest of the world. The purpose of RoOs is to ensure that the preferential FTA tariffs is afforded only to fellow FTA partners, and to avoid trade deflection, meaning that products from a non FTA member is shipped through a low tariff FTA member only to be transshipped into another, high tariff FTA members territory, and in that way benefit from the lower FTA tariff which follows from the FTA tariff concessions. In effect, RoO helps protect FTA members from abuse of their preferential tariffs; the RoO functions as a, artificial, common external trade barrier for FTAs in the absence of a “real” external barrier as of a customs territory, or a CU.

The problems with RoO are many, however, only the two main problems will be discussed here. First, RoOs are accused of being used as a protectionist tool. Second, because RoO are extremely detailed and complicated, RoOs presumably, raise transaction costs.

The issue of RoOs being used for protectionist purposes has been raised time and again. Nevertheless, a problem facing the critics is that RoOs are essential for the formation of a FTA. Therefore, RoOs are justified, as long as FTAs are permitted.

¹³⁴ *Turkey-Textiles Appellate Body Report, WT/DS34/AB/R, paragraph 50*

However, it shall be remembered that CUs also employs RoO during the transitional phase of a CU but also for categories of goods where it has been hard to reach an agreement on a common external tariff.¹³⁵ Moreover, most CUs are entangled in several FTAs for example the EC at present has 36 RTAs in force.¹³⁶

The protectionist use of RoOs has been argued to fall under the concept of ORC and therefore should be subject to “not become higher or more restrictive” after the formation of a RTA than prior to its formation (ORC, paragraph 5).¹³⁷ The Negotiating Group on Rules has presented three different opinions regarding RoO and ORCs.¹³⁸

- 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.
- 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 the trade *vis-à-vis* third parties.¹³⁹

This analysis will not cover all the aspects of the three listed opinions, rather a brief analysis of the textual basis for the assumption that RoO constitutes an ORC.

Looking at the text of paragraph 5, “duties and ORCs 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 free trade area”. The majority of FTAs are formed without any prior existing free trade agreement in place, meaning that there are rarely any pre-existing RoOs which can become higher or more restrictive. The

¹³⁵ *Estevadeordal, Antoni & Suominen, Kati*, “Rules of Origin: A World Map and Trade Effects, Integration”, Trade and Hemispheric Issues Division, Integration and Regional Programs Department Inter-American Development Bank & University of California, San Diego, 2003, p2
http://ctrc.sice.oas.org/trc/Articles/Regionalism/Estevadeordal_Soumin2003.pdf

¹³⁶ See, The European Commissions webpage,
http://ec.europa.eu/trade/issues/bilateral/countries/index_en.htm

¹³⁷ *Rivas, José Antonio*, “Do Rules of Origin in FTAs comply with Article XXIV GATT”, in *Bartels, Lorand & Ortino, Federico*, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 153-154

¹³⁸ *Negotiating Group on Rules, Compendium of Issues Related to Regional Trade Agreements Background Note by the Secretariat May 8, 2002, TN/RL/W/8/Rev.1,(August 1, 2002), paragraph 78*

¹³⁹ *Negotiating Group on Rules, Compendium of Issues Related to Regional Trade Agreements Background Note by the Secretariat May 8, 2002, TN/RL/W/8/Rev.1,(August 1, 2002), paragraph 78*

wording of paragraph 5 does consequently not permit that interpretation. Nevertheless, the complete absence of restrictions regarding RoOs would open for widespread discrimination. Furthermore, as some commentators points out, the purpose of Article XXIV is clear; to facilitate intra-FTA trade and not to raise barriers to the trade of non-FTA members.¹⁴⁰ However, the operative rules regarding RTAs in paragraph 5 and 8, does not provide a textual basis for an interpretation which encompasses RoO in the ORC concept, neither the ORRC concept.¹⁴¹

This is clearly a dilemma, since RoOs obviously can be, and *de facto* are used for protectionist reasons. As an example, when the Canadian-US Free Trade Agreement (CUSFTA) became the North American Free Trade Agreement (NAFTA) after the inclusion of Mexico, the prior CUSFTA RoOs on ketchup admitted ketchup made in CUSFTA as being of CUSFTA origin irrespective of where the tomato paste originated, most tomato paste at this time was imported from Chile. After the inclusion of Mexico in the agreement, new NAFTA RoOs were adopted, which no longer permitted NAFTA ketchup consisting of tomato paste originating from outside NAFTA. The result was, not very surprisingly, that Mexico became the main provider of tomato paste to the NAFTA ketchup factories, and consequently, Chile missed out on its tomato paste export to the United States and Canada.¹⁴²

There are obviously reasons for a complete overhaul of the rules on RoOs. For this purpose WTO initiated a program with the goal of harmonizing RoOs. A product of that program is “The Agreement on Rules of Origin” which is merely a schedule for the harmonization process, which was scheduled to be finished by 1998.¹⁴³ Regretfully, that did not concretize and the work on harmonizing RoOs in the WTO

¹⁴⁰ Article XXIV:4 GATT 1994

¹⁴¹ *Turkey-Textiles, Appellate Body Report, WT/DS34/AB/R, paragraph 57. Where the Appellate Body stated 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.”*

¹⁴² **Rivas, José Antonio**, “Do Rules of Origin in FTAs comply with Article XXIV GATT”, in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 151

¹⁴³ **Estevadeordal, Antoni; Harris, Jeremy & Suominen, Kati**, “Multilateralizing Preferential Rules of Origin Around the World”, *Integration and Trade Sector Department (INT) of the Inter-American Development Bank, Washington, 2007, p 8*
http://www.wto.org/english/tratop_e/region_e/con_sep07_e/estevadeordal_harris_suominen_e.pdf

is, at present (2008), still not finished.¹⁴⁴ As a contrast, the EC successfully launched a harmonized RoO-list under the name Paneuro and Paneuro-Med, the so called “single list RoO”, has been in force since 1999, currently all the 27 members of the EC and 17 other states are using the single list RoO.¹⁴⁵

The second problem with RoOs is the costs involved for producers who wish to enjoy the benefit of the FTA-tariff; the RoO are virtually impenetrable, even for a law scholar. This is a huge obstacle for small and medium sized companies, who cannot afford to hire a law-firm. In many cases the MFN-tariff on a certain good is so low that the extra work of complying with the complicated RoOs are not worth the time. As an example, the “NAFTA take-up rates were as low as 55 per cent in some industries, although since MFN rates were zero on a third of industries the incentive to trade under NAFTA procedures was muted”.¹⁴⁶ As a conclusion on this subject, a rather sententious solution to the spaghetti bowl problem will be cited;

“One can posit mechanisms that would allow regions with particularly dense sets of overlapping RTAs (for example the Americas and perhaps Asia) to replace the spaghetti bowl with something more like a plate of lasagna”¹⁴⁷

Sure sounds like a good idea.

¹⁴⁴ Committee on Rules of Origin, Thirteenth Annual Review of the Implementation and Operation of the Agreement on Rules of Origin, G/RO/65, November 30, 2007. The delegations in the CRO felt that the difficulties they had encountered on the “implications” issue and in the sector of machinery was such that guidance from the General Council was now warranted on how to take these issues forward. The recommendation of delegations in the CRO was that work on these issues be suspended until such guidance from the General Council would be forthcoming. Italics added

¹⁴⁵ Commission Regulation (EC) No 46/1999 of 8 January 1999 amending Regulation (EEC) No 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code

¹⁴⁶ Do, Viet D. & Watson, William, “Economic Analysis and Regional Trade Agreements” in **Bartels, Lorand & Ortino, Federico**, “Regional Trade Agreements and the WTO Legal System”, Oxford University Press, 2006, p 19

¹⁴⁷ **Estevadeordal, Antoni; Harris, Jeremy & Suominen, Kati**, “Multilateralizing Preferential Rules of Origin Around the World”, Integration and Trade Sector Department (INT) of the Inter-American Development Bank, Washington, 2007, p 8 and p 1
http://www.wto.org/english/tratop_e/region_e/con_sep07_e/estevadeordal_harris_suominen_e.pdf

12 XXIV:5 The External Requirements

XXIV:5 GATT 1994

Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; Provided that:

(a) with respect to a customs union, or an interim agreement leading to a formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;

(b) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement as the case may be; and

As explained above, paragraph 5 holds the second set of conditions to be met for a RTA to be formed in coherence 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 as paragraph 8, were the provisions for CUs (a) and FTAs (b) are treated separately. However, the chapeau of paragraph 5 holds operative language, stating the important MFN exception and referring forward to paragraphs 5-9 as stipulating the conditions for MFN deviation, with the phrase “Provided that:..” but also referring backwards to paragraph 4 with the introductory phrase “Accordingly, the provisions...” as an indication of the chapeau as being a continuation of paragraph 4 and that the two provisions shall be read together.

The expression “other regulations of commerce” found under sub-section (a) and (b) has been exhaustively treated in 11.1.3. ORRC and ORC, the chapeau of paragraph 5 will be treated in 14.1 under the heading “Case law” sub-section “Turkey-Textiles” for this reason those requisites will not be treated in this chapter.

What remains to be treated is the requirement to not raise trade barriers externally, by the imposition of higher duties or more restrictive regulations of commerce, than prior to the formation of the RTA. The FTA requirements are distinguished by requiring this from each constituent member, as opposed to a CU where the general incidence of such trade barriers is supposed to constitute the benchmark for assessment.

12.1 Duties and ORCs...shall not (on the whole) be higher or more restrictive...

This phrase calls for a comparison between the average incidence of duties and ORCs prior to, and after the formation of a RTA in order to establish whether those (duties and ORCs) have become higher or more restrictive as a consequence of the formation. Consequently, the purpose of paragraph 5 is to prevent the formation of a RTA to be used 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) treats CUs and 5(b) treats FTAs.

12.1.1.1 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

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. For this reason paragraph 5 calls for an assessment of the general incidence of duties and ORCs applicable in each customs territory prior to the formation, compared to the general incidence of duties and ORCs in the commonly applied trade regime, after the formation. The assessment is in further detail explained 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”¹⁴⁸

This provision provides a structure for the quantification of duties and charges, which are easily quantifiable¹⁴⁹, furthermore it clarifies that it is the applied rates of duty that shall be taken into consideration.¹⁵⁰ Still, it falls short of providing a practical structure for the quantification and aggregation of other regulations of commerce, where 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

¹⁴⁸ *Understanding on the Interpretation of Article XXIV, paragraph 2, (emphasis added)*

¹⁴⁹ *Other duties and charges, are a residual category of “ordinary customs duties” and are described as “import –related financial charges which are not ordinary customs duties” for example an import surcharge, i.e. a duty imposed on an imported product in addition to the ordinary customs duty, a security deposit, a statistical tax imposed to finance the collection of statistical information or a customs fee, i.e. a financial charge imposed for the processing of imported goods, Van Den Bossche, Peter “The Law and Policy of the World Trade Organization”, Cambridge University Press, 2005, p 436-437*

¹⁵⁰ *The applied rate of duty is the duty which is actually charged, since MFN only sets a upper limit of duties, i.e. the bound rate of duty, a WTO member retains the right to lower its duties, which is actually very common, for example the bound tariff of Costa Rica is 45% but the duties actually applied is just above 6%, see, Van Den Bossche, Peter “The Law and Policy of the World Trade Organization”, Cambridge University Press, 2005, p 422*

quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required.”¹⁵¹

The problem of non-tariff barriers to trade such as ORCs has been recognized earlier, in the Agreement on agriculture, a method for “tariffication” of non-tariff barriers was implemented.¹⁵² 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 for actually raising barriers to trade instead of dismantling them.

12.1.1.2 Paragraph 6

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 an effect of the CU-formation, some duties may be raised and some lowered as long as the general incidence of duties has not become higher than prior to the CU-formation. Paragraph 6 merely establishes a compensatory procedure in a case where certain non-CU members are affected by the imminent increase of a certain duty as an effect of the CU-formation. The very existence of paragraph 6 regarding CUs, indicates, *a’contrario* that a FTA formation is not entitled to a corresponding increase of duties.¹⁵³

12.1.1.3 5(b) Free Trade Areas

The members of a FTA are not required to create a common external trade regime, which in effect means that each constituent member to a FTA leaves its original duties and ORCs intact *vis á vis* non-FTA-members. Therefore, paragraph 5(b) merely calls for, each FTA-members, prior trade regime, to be compared to each FTA-members trade regime after the formation of the FTA. The purpose of the comparison is to establish whether the duties and ORCs have become higher or more restrictive due to the formation of the FTA. Paragraph 6 leaves no room for any increase of duties or ORCs to FTA formations.

¹⁵¹ *Understanding on the Interpretation of Article XXIV, paragraph 2*

¹⁵² *The Agreement on Agriculture*

¹⁵³ *Lockhart, Nicolas JS, & Mitchell, Andrew David, “Regional Trade Agreements under GATT 1994: An Exception and its Limits” in Mitchell, Andrew David, “Challenges and Prospects for the WTO”, Cameron May International Law & Policy, London, 2005, p 251*
<http://www.worldtradelaw.net/articles/lockhartmitchellrta.pdf>

13 The Committee on Regional Trade Agreements (CRTA)

In February of 1996 the Committee on Regional Trade Agreements (CRTA) was established by the WTO General Council to function as a single body with the main objective to examine RTAs conformity under GATT XXIV, and under certain circumstances, also under GATS Article V and/or the Enabling Clause. In addition, the CRTA also has a mission to facilitate a streamlined reporting process and to deal with “systemic issues” regarding RTAs, such as legal analysis of relevant GATT provisions on RTAs.¹⁵⁴ However, the CRTA did not function properly; no examination by the CRTA has been concluded as consistent with GATT XXIV due to lack of consensus on how to interpret Article XXIV.¹⁵⁵ Consequently, the monitoring of the observance of Article XXIV is more or less non-existent, lack of control functions are obviously a threat to the proper functioning of such a vital exception as the one stated in Article XXIV. This has been addressed as a major issue but no consensus has been reached so as to afford the CRTA with a powerful tool to enforce the provisions of Article XXIV.

However, in December of 2006, a Transparency Mechanism (TM) on RTAs was provisionally adopted which in many aspects has revised the CRTAs work. The TM aims at making RTAs easier to examine for all contracting parties, mainly by requiring members to a RTA to give early announcement about entering RTA-formation-negotiations, requiring RTA-members to provide the WTO with information needed for a proper examination.

It is yet to see, whether the TM has made any difference on the CRTAs efficiency, however it is doubtful that transparency can remedy the crippled examination process, since the main reason for its ineffectiveness has been interpretational issues.¹⁵⁶ In this aspect the TM seems to be a blunt weapon since it does not hold any means to enforce the provisions of Article XXIV. Nevertheless, the purpose of transparency is to afford

¹⁵⁴ *Report 2007 of the Committee on Regional Trade Agreements, WT/REG/18, (December 3, 2007), paragraph 4. As of 1 November 2007, 385 regional trade agreements (RTAs) have been notified to the GATT or WTO, 197 of which are currently in force. Of the agreements in force, 125 were notified under GATT Article XXIV; 22 under the Enabling Clause, and 50 under GATS Article V.*

¹⁵⁵ “However, during the GATT, the Working Party examining the Czech Republic-Slovak Republic Customs Union was able to conclude that the Agreement was consistent with the provisions of GATT Article XXIV”. See *The World Trade Report 2007*, footnote 304, p 306

¹⁵⁶ http://www.wto.org/english/tratop_e/region_e/trans_mecha_e.htm

http://www.wto.org/english/tratop_e/region_e/regcom_e.htm

WTO members information on whether a certain RTA is in consistency with Article XXIV and thereafter invoke an eventual breach of XXIV, before a Panel or the Appellate Body, as a reason for non approval of MFN deviation, in this way all intra-regional preferences would be considered a violation of MFN, however this is yet to be seen. Most WTO members are too entangled in their own RTAs to dare to challenge any other RTA, thus this could perhaps be self incriminating, since no one really knows the benchmarks for fulfillment of Article XXIV.

14 Case Law

14.1 The Turkey-Textiles case

The chapeau of paragraph 5 holds the MFN exception, although not expressly noted, it is supposed to be understood from the phrase, “*the provisions of this agreement...shall not prevent the formation of a CU/FTA...*” The Turkey-Textiles case came to revolve mainly around this phrase the question being if that phrase could be interpreted as justifying more than merely MFN deviation? When read as an isolated phrase, the wording would certainly allow such interpretation, but, as the Appellate Body concluded, the phrase cannot and shall not be ripped out of its context, it would be contrary to the VCLT and such a reading would certainly deteriorate the very pillars of GATT and dilute the purpose covered by Article XXIV.

In 1995 Turkey's EU Association Council finalized the agreement creating a CU between Turkey and the EU, for this reason Turkey initiated a harmonization process of the Turkish economy in order to conform to EU's common external trade regime in accordance with the requirements in Article XXIV:8(a)(ii). For that reason Turkey introduced quantitative restriction on textiles originating in India starting at January 1, 1996.¹⁵⁷ However, the quantitative restrictions applied on the behalf of EU, was permitted during a phase out period, according to the Agreement on Textiles and Clothing (ATC). The agreement does no longer exist, as of January 1, 2005, because from the implementation date in 1995 and 10 years forward, all quantitative restrictions were to be phased out, and consequently were.¹⁵⁸ Turkey did not have any quantitative restrictions in place when the ATC went into force, and had, for that reason, no quantitative restriction to phase out under the ATC. Therefore, Turkey's implementations of new quantitative restrictions against India were certainly out of the ordinary, despite the fact that they were “explained” by Turkey's accession to EU.

India claimed that Turkey's quantitative import restrictions were inconsistent with the GATT and ATC, India argued that Turkey's restrictions violated GATT 1994;

- Article XI (General Elimination of Quantitative Restrictions),

¹⁵⁷ *Turkey-Textiles Panel Report, WT/DS34/R, 2.31-2.46*

¹⁵⁸ *The Agreement on Textiles and Clothing, Article 9*

- XIII (Non-discriminatory Administration of Quantitative Restrictions), and
- Article 2.4 of ATC

Finally India argued that Turkey's violation of Article XI), XIII and 2.4 was not justified under Article XXIV.¹⁵⁹ Turkey's response was mainly treating India's unwillingness to negotiate with Turkey, and that India had not

*“sufficiently exhausted the avenues of Article XXII of GATT, Article 4 of the DSU and Article XXIV of GATT in order to bring about an amicable settlement and adjustment.”*¹⁶⁰

Consequently Turkey did not rebut India's claim on the violation of Article XI, XIII GATT and 2.4 ATC, instead Turkey invoked Article XXIV as justifying the violations of the same articles, and that Turkey's accession to EU would be rendered impossible if Turkey would not be allowed to impose the restrictions. Moreover, Turkey claimed that XXIV:5-9 was *lex specialis* in comparison to the rest of GATT 1994 because:

*“Article XXIV is in part III of GATT, and not in Part II together with other provisions on commercial policies”*¹⁶¹

And that a CU formed in compatibility with the rules in XXIV:5-9 was “relieved” from conformity to other GATT rules. India resorted to a simple indication of the absurdity of that claim.¹⁶²

The Panel concluded that Turkey's quantitative restrictions was a violation of Article XI, XII and as a consequence also 2.4. Therefore the case came to center around the question of whether Article XXIV could justify Turkey's imposition of quantitative restrictions.¹⁶³

The Panel responded to Turkey's claim as XXIV being *lex specialis*;

¹⁵⁹ *Turkey-Textiles Panel Report, WT/DS34/R, 5.1-5.3*

¹⁶⁰ *Ibid, at 5.4(i)*

¹⁶¹ *Ibid, at 9.88*

¹⁶² *Ibid, at 9.88,89*

¹⁶³ *Ibid, at 9.86*

*“The relationship between Article XXIV and GATT/WTO seems to us to be self-evident from the wording and context of Article XXIV”.*¹⁶⁴

Consequently, the *non-lex specialis* nature of XXIV implies that XXIV would have to expressly permit a deviation from XI, XIII and ATC 2.4 to render possible Turkey’s deviation from the same provisions, however XXIV does not expressly authorize the departure from XI, XIII and ATC 2.4. Moreover, the flexibility embedded in the expression “substantially all” in paragraph 8(a)(ii), neither expressly permits deviation from the XI, XIII and ATC 2.4. As a consequence the panel stated,

*“We draw the conclusion that even on the occasion of the formation of a customs union, Members cannot impose otherwise incompatible quantitative restrictions”*¹⁶⁵

Turkey appealed the Panels decision to the Appellate Body; Turkey’s key arguments were;

- The ORRCs were not on the whole higher after the formation of the CU.¹⁶⁶
- Again, the XXIV is an autonomous right, located in part III of GATT and is therefore isolated from the rest of GATT, with no further explanation beyond that already declared in the Panel report.¹⁶⁷
- XXIV includes a permission to deviate from MFN, but is not limited to that.¹⁶⁸
- The phrase “the provisions of this agreement shall not prevent... the formation of a customs union” in the chapeau of paragraph 5, is to be interpreted as embracing all of the provisions of GATT 1994, including those of XI, XIII and ATC 2.4.¹⁶⁹

¹⁶⁴ *Turkey-Textiles Panel Report, WT/DS34/R, 9.186*

¹⁶⁵ *Ibid, at 9.189*

¹⁶⁶ *Turkey-Textiles Appellate Body Report, WT/DS34/AB/R, paragraph 8*

¹⁶⁷ *Ibid, at 9, 15*

¹⁶⁸ *Ibid, at 10*

¹⁶⁹ *Ibid, at 12*

- Since the textiles and clothing at issue in the case comprised 40 % of Turkey's trade with EU, Turkey would not be able to meet the SAT criterion and as a consequence the formation of the CU would be prevented.¹⁷⁰
- “The panel erred... by not reviewing whether GATT/WTO practice prohibited the introduction of such measures”, as opposed to examining whether GATT permitted such measures (quantitative restrictions).¹⁷¹

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.¹⁷² The Appellate Body construed the so called “two tier test” on the basis of an interpretation of the chapeau of paragraph 4 and 5. The Appellate Body found that paragraph 4 and 5 were linked together by the word “accordingly” found in the opening of paragraph 5. The Appellate Body concluded that “accordingly” can only be referring backwards to paragraph 4. As a consequence the chapeau of paragraph 5 cannot be read isolated from the purposive statement in paragraph 4. The essential part of paragraph 4 reads;

“...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...”

Accordingly, the chapeau of paragraph 5 shall be interpreted in the light of the objective of not raising barriers of trade to third countries.¹⁷³ This interpretation also coincides with the statement in the Understanding on Article XXIV, that members to a RTA should;

*“to the greatest possible extent avoid creating adverse affects on the trade of other members”.*¹⁷⁴

According to the Appellate Body, those findings indicated that Article XXIV may permit measures which are otherwise inconsistent with other GATT provisions if;

¹⁷⁰ *Turkey-Textiles Appellate Body Report, WT/DS34/AB/R, paragraph 17*

¹⁷¹ *Ibid, at 20*

¹⁷² *Ibid, at 43*

¹⁷³ *Ibid, at 57*

¹⁷⁴ *Understanding on Article XXIV, Preamble*

1. *“the party claiming the benefit of this defense must demonstrate that the measure at issue is 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*
2. *“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”*¹⁷⁵

The Appellate body proceeded, and made a remark on that whether the European Communities was a CU which met the requirements of paragraphs 8(a) and 5(a) had not been appealed and the issue for that reason was not before them.¹⁷⁶ Consequently the first part of the two tier test was presumed to be met. The second part of the test, whether the formation of Turkey’s accession to the EC would be prevented if Turkey were not allowed to introduce the quantitative restrictions to India, was however considered relevant for the Appellate Body to review. In this way the Appellate Body had reduced the issue to the question of whether Turkey would not be able to fulfill the SAT criterion unless they were allowed to introduce the quantitative restriction upon India, and as a consequence, prevent the formation of the CU between Turkey and the EC.¹⁷⁷ The Appellate Body concluded that this was not the case, the CU would not be prevented on the basis of non-application of the restrictions, since there were other options available to Turkey besides quantitative restrictions to accomplish the sought for cause, i.e. to avoid trade deflection, were Turkey would function as a transshipment state for textile and clothing imports destined for the European market. The Panel had in their examination also pointed out alternative measures for Turkey to accomplish the prevention of trade deflection suggesting that Turkey instead could adopt Rules of Origin, increased tariffs, early phase-out, or tariffication.¹⁷⁸ The Appellate Body agreed with the Panel that Rules of Origin would pose a less restrictive measure and suggested that as a resort for Turkey to satisfy the ECs demands for trade deflection prevention. Consequently, the Appellate Body

¹⁷⁵ *The Turkey-Textiles Appellate Body Report, WT/DS34/AB/R, paragraph 58*

¹⁷⁶ *Ibid, at 60*

¹⁷⁷ *Ibid, at 61*

¹⁷⁸ *Turkey-Textiles Panel Report, WT/DS34/R, 9.190*

recommended Turkey to bring its measures into conformity with Article XI, XIII and ATC 2.4.¹⁷⁹

14.2 Other XXIV cases

There are four similar cases covering the issue of discriminatory application of safeguard measures, where parties to a RTA have been excluded from safeguard measures, in violation of the MFN principle pursuant to the Agreement on Safeguards Article 2.2. The defendants have claimed that Article XXIV justifies this line of action, due to the requirement in XXIV:8 to eliminate substantially all ORRCs in the intra-regional trade. For example, in the US-Line Pipe case where United States applied safeguard measures in the form of an increased duty on *Circular Welded Carbon Quality Line Pipe*, to all WTO members except Canada and Mexico, fellow NAFTA members. In all cases the Appellate Body has refused to answer the question of whether XXIV could provide a justification for not applying safeguards on a MFN basis (*Agreement on Safeguards 2.2*). Instead the Appellate Body has concentrated on the parallelism requirement in the Agreement on Safeguards 2.2, stating that;

*“...we find that the United States has violated Articles 2 and 4 of the Agreement on Safeguards by including Canada and Mexico in the analysis of whether increased imports caused or threatened to cause serious injury, but excluding Canada and Mexico from the application of the safeguard measure, without providing a reasoned and adequate explanation that establishes explicitly that imports from non-NAFTA sources by themselves satisfied the conditions for the application of a safeguard measure”.*¹⁸⁰

Similar statements can be found in the following Appellate body reports;

- *Argentina-Footwear (WT/DS121/AB/R), paragraph 113 and 151(d)*
- *US-Wheat Gluten (WT/DS166/AB/R), paragraph 98 and 187(c)*
- *US-Steel Safeguards (WT/DS248/AB/R), paragraph 474 and 513(e)*¹⁸¹

¹⁷⁹ *Turkey-Textiles Appellate Body Report, WT/DS34/AB/R, paragraph 66*

¹⁸⁰ *US-Line Pipe, Appellate Body Report, WT/DS202/AB/R, paragraph 178*

¹⁸¹ *WT/DS249/AB/R, WT/DS251/AB/R, WT/DS252/AB/R, WT/DS253/AB/R, WT/DS254/AB/R, WT/DS258/AB/R, WT/DS259/AB/R*

15 Legal Conclusion

The VCLT, the drafting history and the purpose of Article XXIV forms the foundation for a strict interpretation of the provision. VCLT provides the basis for the textual interpretation, the drafting history reveals the purpose of XXIV and together they provide the necessary tools for the solution of the XXIV Gordian Knot dilemma. Even if Article XXIV may be poorly drafted, it still holds the necessary instruments for a sound control of the RTA formation, so that RTAs contributes to the Multilateral Trading System (MTS) instead of counteracting the same. This discovery is important due to the complexity of rewriting XXIV; if the Article can be utilized as it is a lot of time and effort can be spared, and the current RTA proliferation can be curbed within a reasonable time frame. Of course the prerequisite of this reasoning is that XXIV adherence as such will be challenged in the DSU, and this has not yet happened, probably due to the risk of self incrimination, it seems as this is a typical catch 22 situation.

The following are the conclusions of the XXIV legal analysis:

ORRC is the same as border measures, including internal measures, such as TBT/SPS, if they are applied discriminatory. Trade remedies in Article VI and XIX are encompassed by the *ORRC* and shall therefore be eliminated with respect to substantially all the trade.

The *exceptions list* is exhaustive and shall be interpreted as to allow the listed Articles to remain applicable where necessary on the substantially all part of trade without any detraction from it. Articles not listed e.g. VI and XIX cannot remain applicable on the substantially all part of trade, however those may remain to the extent that they do not impede the SAT. The correct interpretation of the exceptions list is consequently the May-Must version.

SAT is composed of a qualitative as well as a quantitative component, as a consequence of the qualitative component, entire sectors, such as agriculture, cannot be left out from liberalization. The calculation of SAT is still not solved, but an estimate of between 90-95 % of all trade seems reasonable.

Elimination of ORRCs in respect to SAT, means that no intra-regional “authorizing provisions” can be retained on the SAT part of trade.

Regarding the *insubstantial part of all trade*, intra-regional “authorizing provisions” may be retained if the “authorizing provision” does not apply to a part of trade exceeding the insubstantial part of all trade, i.e. enables a restrictive regulation of trade that affects more than 5-10% of the intra-regional trade, or affects a trade sector which in total corresponds to the 5-10% benchmark, since this would be a breach of the qualitative component of SAT. This means that a RTA may qualify for MFN exception one day but not necessary the next, and this is on the RTA members own risk, i.e. a RTA may not be able to invoke the XXIV exception to MFN if they at that certain point in time does not qualify under the SAT criterion.

ORC in paragraph 5 has the exact same meaning as ORRC in Paragraph 8.

ORC in paragraph 8(a)(ii) has a broader scope than ORRC in 8(a)(i) and 8(b) and therefore encompasses not only border measures, but also internal measures, calling for a harmonization of the external trade regulations of a CU includes an internal harmonization of trade regulations by necessity.

Classifying *RoOs* as ORRCs is not feasible due to the operative rules regarding RTAs in paragraph 5 and 8, which does not provide a textual basis for an interpretation which encompasses RoO in the ORC concept, neither the ORRC concept.

15.1 Loose ends

Application of trade remedies to RTA partners; uncertainty remains, however the Appellate Body in Turkey-Textiles indicated that there is some flexibility in the SAT criterion, which can be understood as to mean that trade remedies can be applied to RTA partners on the insubstantial part of all trade. However, the Appellate Body has refused to answer the core question; can Article XXIV justify non application of trade remedies to RTA partners?

Are *unnecessary TBT/SPS measures* encompassed by ORRC? Such measures are for certain encompassed by the purpose of ORRC, but it remains uncertain if they can be read into the ORRC criterion on a textual basis.

SECTION IV

GENERAL CONCLUSIONS

16 General Conclusions

The main legal problems of Article XXIV are:

- The main fault in XXIV is the inclusion of FTAs, CUs may benefit the MTS, meanwhile it is highly uncertain if FTAs may do the same.
- The requirements for the formation of a FTA are too weak, which results in a much too easily achieved right of MFN deviation, thus undermining the core MFN principle of GATT.
- The CRTA has, so far, failed to carry out a functioning examination and control of the observance of Article XXIV.
- The difficulties of interpreting Article XXIV lies on the whole in the above facts, CUs and FTAs cannot be governed by similar rules, since they are not similar.

The main forces behind the recent RTA proliferation are:

- The path of least resistance; FTAs are relatively easy to conclude and in that aspect benefits the MTS by dismantling barriers to trade which, in the absence of a FTA exception would likely *not* have been dismantled. However the negative effects of FTAs, such as the relatively shallow integration, i.e. no common internal market/external borders in addition to the spaghetti bowl of RoOs which is the product of FTA proliferation, by far outweighs the positive effects according to this author.
- Short term economic benefits
- Relinquished Doha negotiations

The opinion that has influenced me the most is the one presented by Valentin Zahrnt in his paper “How Regionalization can be a pillar of a more Effective World Trade Order”. His conclusion is that RTAs are good as long as they are taking the form of a “Deep Regional Integration” as opposed to “Shallow Regional Integration”. The Deep Regional Integration consists mainly of CUs such as the EC. The reason for the latter being preferable to the former is that such integration cuts down on voting members in the WTO negotiations, and that for example the EC RTA has positive side effects such as increasing homogeneity, free flow of natural persons as well as corporations and capital. Zahrnt’s opinions on those points are relevant. However, it is questionable if he is not being overly optimistic when he concludes that shallow integrated areas, FTAs, can develop into a CU. Of course that may occur, but is it probable that they will do so in a rate that can compensate for the negative effects of FTAs and/or within a foreseeable future?

Pandora’s Box has been opened; the question is if it is possible to close it again? Hopefully the WTO-members will recognize the apparent flaws of shallow integration as FTAs whether bilateral or plurilateral, and find it easier and more effective to solve problems that concern us all at a multilateral level. A common enemy which perhaps can bring the Contracting Parties back to the negotiation table might be the imminent environmental problems the world is facing today. Natural disasters has a tendency of striking rich as well as poor and hopefully such disasters may lead to a common understanding - that we are all in this together.

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