

CHALLENGES AND PROSPECTS
FOR THE WTO

Andrew D Mitchell

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REGIONAL TRADE AGREEMENTS UNDER GATT 1994: AN EXCEPTION AND ITS LIMITS*

NICOLAS JS LOCKHART[†] AND ANDREW D MITCHELL[‡]

In this chapter, the authors examine the nature of the exception for regional trade agreements (RTAs) under Article XXIV:5 of GATT 1994. This exception, which aims to maximise the internal trade-liberalising effects of an RTA while minimising its external trade-restricting effects, applies specifically to measures adopted upon the formation of customs unions and free-trade areas. It can be used to justify a departure from other provisions of GATT 1994 (such as the obligation to provide most-favoured-nation treatment to all WTO Members under Article I) and, in certain circumstances, the provisions of other WTO agreements. However, the exception is subject to detailed conditions. In particular, in broad terms, the restrictions that parties to an RTA impose on trade within the RTA must be eliminated, while restrictions on trade outside the RTA should not be higher than before the RTA was formed. In the case of a customs union, external trade restrictions should be substantially harmonised. In determining whether a given RTA meets these conditions, several questions arise, many of which are yet to be fully explored in dispute settlement or resolved by negotiation among the WTO Membership.

* This chapter is based on a paper prepared by Nicolas Lockhart while at the Trade Law Centre for Southern African (TRALAC). That paper forms part of a project conducted by TRALAC and the World Trade Organization on the economic and legal implications of the Economic Partnership Agreements that certain African, Caribbean and Pacific countries are currently negotiating with the European Union (see www.tralac.org). The views expressed in this chapter are those of the authors.

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I INTRODUCTION

The global trading system is now comprised of an inter-locking, ever-growing, network of regional and multilateral trade agreements. It would be easy to assume that trade agreements, whether multilateral or regional, are necessarily beneficial for trade. After all, such agreements pursue the common goal of trade promotion through liberalisation. More trade agreements of whatever type might, therefore, translate into more trade liberalisation. The short-coming of this assumption is, however, that multilateral and regional agreements pursue this goal in different and often conflicting ways. A core objective of the multilateral trading system is 'the elimination of discriminatory treatment in international trade relations'.¹ In pursuit of this objective, WTO Members must accord equal treatment to the goods and services of all other WTO Members (through 'most-favoured-nation' or 'MFN' treatment).² In contrast, regional trade agreements (RTAs) pursue trade liberalisation through precisely this type of discrimination. The parties to an RTA liberalise trade solely among themselves, creating a network of special preferences within the RTA that are not available to other WTO Members. RTAs, therefore, entrench the very discrimination that WTO rules seek to eliminate. This key difference in approach makes the relationship between multilateralism and regionalism both complicated and controversial. In economic terms, it is still not clear whether maintaining an ever-growing network of RTAs alongside multilateral rules produces an overall increase or decrease in economic welfare. In legal terms, the coexistence of the WTO and RTAs among WTO Members creates a complex system of competing international rights and obligations.

As RTAs involve discrimination contrary to the general MFN obligation, they would normally give rise to inconsistencies with WTO rules. However, the WTO agreements contain a series of exceptions for RTAs that allow limited derogation from WTO rules for RTAs meeting certain conditions. Only RTAs falling within one of these exceptions are valid under WTO law. In other words, a WTO Member must ensure that any RTA to which it is a party complies with the conditions of the relevant WTO exception. Otherwise, the Member risks acting inconsistently with its WTO obligations. The RTA exceptions are contained in: Article XXIV of GATT 1994; paragraph 2(c) of the Enabling Clause;³ and Article V of

¹ WTO Agreement, Preamble.

² GATT 1994, art I; GATS, art II.

³ Decision on Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries, GATT Document L/4903, BISD 26S/203 (28 November 1979) (Enabling Clause). As a decision of the GATT CONTRACTING PARTIES, the Enabling Clause forms part of GATT 1994: see para 1(b)(iv) of the language incorporating GATT 1994 into the WTO Agreement.

GATS. The first two exceptions apply to RTA provisions relating to goods, while the third applies to RTA provisions relating to services. An RTA covering both goods and services would generally need to comply with the relevant exceptions for both goods and services.

Few provisions of GATT 1994 have inspired as much controversy and disagreement as Article XXIV. The WTO Members themselves are divided on almost every issue of significance in this exception and the process for WTO review of RTA is largely ineffective. Although 149 RTAs have been notified to the WTO since it was established in 1995,⁴ none has completed the examination process to determine its WTO-consistency. Ironically, this comes at a time when the WTO exceptions for RTAs should have taken on increasing importance because of the unprecedented proliferation of RTAs among WTO Members.⁵ In addition, although the Appellate Body recently issued its first decision on the Enabling Clause,⁶ the Appellate Body has provided very little substantive guidance on Article XXIV of GATT 1994 or Article V of GATS. Therefore, it is worth examining these exceptions to identify the main areas of controversy and uncertainty, particularly as they are subject to negotiation in the current Doha Round and may arise in future disputes.

This chapter addresses the substantive aspects of the exception for RTAs in relation to goods under Article XXIV, beginning with an explanation of its structure and scope. The chapter goes on to examine in detail the conditions with which RTAs must comply in order to fall within the exception — these conditions relate to the elimination of restrictions on trade between the parties to the RTA, and to the nature and level of restrictions that the parties to the RTA impose on trade with WTO Members that are not party to the RTA.

II SCOPE OF THE GATT EXCEPTION FOR RTAs: ARTICLE XXIV:5

A *Exception as Defence*

Article XXIV:5 of GATT 1994 provides an exception to certain WTO obligations for ‘customs unions’ and ‘free-trade areas’ (FTAs), which are

⁴ <http://www.wto.org/english/tratop_e/region_e/summary_e.xls> (Free Trade Agreements and preferential agreements notified) as at 18 September 2004.

⁵ WTO Secretariat, ‘The Changing Landscape of RTAs’ (paper presented at the WTO Seminar on Regional Trade Agreements and the WTO, Geneva, 14 November 2003) para 7. <http://www.wto.org/english/tratop_e/region_e/sem_nov03_e/boonekamp_paper_e.doc>. In this document, the WTO Secretariat reports that, since 1995, notifications of agreements under Article XXIV have been running at an average of 15 per year, whereas in the 45 years of notifications under GATT 1947, the yearly average was less than three.

⁶ See Appellate Body Report, *EC – Tariff Preferences*.

the two possible types of RTAs for the purpose of this chapter. The opening paragraph, or chapeau, of Article XXIV:5 states:

Accordingly, the provisions of this Agreement shall not prevent, as between the territories of Members, the formation of a customs union or of a free-trade area ...⁷

The Appellate Body has indicated that the words 'shall not prevent' in Article XXIV:5 mean that 'the provisions of the GATT 1994 *shall not make impossible* the formation of a customs union'⁸ or, presumably, an FTA.⁹ That is, Article XXIV:5 provides a justification for the adoption of certain RTAs and constitutes a 'defence' to a claim that such an RTA is inconsistent with any provision of GATT 1994.¹⁰ According to the general jurisprudence of WTO panels and the Appellate Body regarding the burden of proof in WTO disputes, this means that it would be for the Member challenging an RTA to establish its inconsistency with a provision of GATT 1994, and for the responding Member to prove that the inconsistency is justified or removed¹¹ because the RTA falls within the exception in Article XXIV:5.¹²

B Purpose of the Exception

The WTO Agreements, including GATT 1994, are to be interpreted according to the words used in the treaty, read in their context, and in the light of the object and purpose of the treaty.¹³ Article XXIV:4 sets out the purpose of the exception in Article XXIV:5 and therefore acts as a guide to understanding and applying that exception. Article XXIV:4 states:

The Members 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.

⁷ Emphasis added.

⁸ Appellate Body Report, *Turkey – Textiles*, para 45 (original emphasis).

⁹ In *Turkey – Textiles*, the Appellate Body was considering a customs union and not an FTA. However, the chapeau of Article XXIV:5 applies to both customs unions (under Article XXIV:5(a)) and FTAs (under Article XXIV:5(b)), so the same reading of the words 'shall not prevent' should also apply to FTAs.

¹⁰ Appellate Body Report, *Turkey – Textiles*, para 45.

¹¹ See Appellate Body Report, *EC – Tariff Preferences*, 100–103.

¹² See, eg, Appellate Body Report, *US – Wool Shirts and Blouses*, 14; compare Appellate Body Report, *EC – Tariff Preferences*, paras 87–88.

¹³ Article 3.2 of the DSU states that the WTO agreements are to be interpreted in accordance with the customary rules of interpretation of public international law. These rules were codified in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties*, opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980): Appellate Body Report, *US – Gasoline*, 17.

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 Members* with such territories.¹⁴

This statement is complemented by the Understanding on the Interpretation of Article XXIV of the GATT 1994 (RTA Understanding), in which WTO Members expand further on the purpose of Article XXIV:5.¹⁵ In the RTA Understanding, WTO Members:

- recognise 'the contribution to the expansion of world trade' that may be made through the establishment of customs unions and FTAs;
- recognise that the expansion of world trade 'is increased' if internal trade restrictions within an RTA are eliminated for 'all trade' and 'diminished if any major sector of trade is excluded'; and
- reiterate that the establishment of an RTA 'should to the greatest extent possible avoid creating adverse effects on the trade of other Members'.¹⁶

In *Turkey – Textiles*, the Appellate Body addressed Article XXIV for the first time. The Appellate Body noted that Article XXIV:4 'does not set forth a separate obligation itself but, rather, sets forth the overriding and pervasive purpose for Article XXIV'.¹⁷ It added that the other provisions of Article XXIV 'must be interpreted in the light of the purpose' through a process of 'constant reference to this purpose'.¹⁸

How can we summarize the purpose of the RTA exception in GATT 1994? Perhaps unsurprisingly, the primary goal of the exception, as reflected in Article XXIV:4 and the RTA Understanding, is the promotion of trade. As noted earlier, the parties to an RTA grant each other special trade preferences that are not offered to other WTO Members. The establishment of an RTA, therefore, creates the potential for positive effects on *internal* trade between the parties (who benefit from the preferences) and negative effects on *external* trade with other Members (who are excluded from the preferences). To secure an overall expansion of world trade, the exception

¹⁴ Emphasis added.

¹⁵ The RTA Understanding forms part of GATT 1994 pursuant to paragraph 1(c)(iv) of the language incorporating GATT 1994 into the WTO Agreement. The RTA Understanding was adopted at the conclusion of the Uruguay Round.

¹⁶ RTA Understanding, Preamble.

¹⁷ Appellate Body Report, *Turkey – Textiles*, para 57.

¹⁸ *Ibid.*

in Article XXIV:5 is designed to maximise the internal trade liberalising effects of an RTA and to minimise its external trade-restricting effects.¹⁹

C *Exception for What?*

1 RTAs Covered

(a) *Customs Unions and Free-Trade Areas*

The exception in Article XXIV:5 of GATT 1994 applies to customs unions and FTAs, as defined in Article XXIV:8(a) and (b) respectively. Broadly, a customs union means 'the substitution of a single customs territory for two or more customs territories, so that'²⁰ almost all restrictions are eliminated with respect to substantially all trade between the parties (that is, internal trade),²¹ and the parties apply substantially the same restrictions to the trade of other countries (that is, external trade).²² Again, in broad terms, an FTA is 'a group of two or more customs territories' in which almost all restrictions are eliminated with respect to substantially all internal trade.

In essence, Article XXIV:8 establishes certain conditions with which an agreement must comply in order to fall within the definition of a customs union or an FTA. In addition, Article XXIV:5 describes certain conditions that a customs union or an FTA must meet in order to benefit from the exception.²³ The conditions imposed on customs unions and FTAs are similar in many respects, as discussed further below.

Many WTO agreements have special rules or flexibilities that apply less onerous disciplines to developing countries as compared to developed countries (an aspect of 'special and differential treatment'). In the context of RTAs, a less onerous definition could have applied to a customs union or an FTA between a developing country WTO Member and a developed country WTO Member.²⁴ For instance, in forming an FTA, a developing country could have been permitted to liberalise its own market to a lesser degree than a developed country partner (so-called 'asymmetrical' obligations). However, the exception in Article XXIV:5 does not expressly include any such flexibilities.

¹⁹ Ibid.

²⁰ GATT 1994, art XXIV:8(a).

²¹ GATT 1994, art XXIV:8(a)(i).

²² GATT 1994, art XXIV:8(a)(ii).

²³ Certain special requirements regarding these conditions may apply under Article XXIV:9 in relation to preferences in respect of import duties or charges as described in Article I:2 of GATT 1994.

²⁴ Certain RTAs concluded between developing countries are covered by the Enabling Clause.

(b) *Interim Agreements*

The formation of an RTA entails significant trade policy coordination among the parties, as well as extensive changes to domestic regulations affecting trade. Article XXIV recognises that WTO Members wishing to enter into an RTA may not be able to achieve the required level of economic integration immediately. Consequently, the exception for RTAs in Article XXIV:5 extends to 'interim agreements' necessary for the formation of customs unions or FTAs, subject to certain requirements. Under Article XXIV:5(c), an interim agreement must lead to the formation of a customs union or FTA 'within a reasonable length of time'. Paragraph 3 of the RTA Understanding specifies that this period 'should exceed 10 years only in exceptional cases'. Although such cases are not defined, where one of the RTA parties is a developing country, the level of development of that party might be an exceptional circumstance justifying an extended period of time for formation of an RTA.

There is some controversy as to when an interim agreement must meet the requirements of Article XXIV:5 and 8. Some Members consider that these requirements need to be fulfilled only at the end of the reasonable period for implementation. Others argue that the requirements of Article XXIV:5 (not raising external barriers to trade) must be met at all stages of implementation.²⁵ This distinction seems to find support in a textual difference between the two paragraphs. Article XXIV:5 explicitly includes 'interim agreements' in the list of agreements that may not impose 'higher or more restrictive' external trade restrictions. In contrast, Article XXIV:8 does not state that 'interim agreements' are subject to the requirement to eliminate internal restrictions on substantially all trade. This suggests that interim agreements need not fulfil the requirements of paragraph 8 but must fulfil the requirements of paragraph 5. This reading of the text is consistent with the purpose of the RTA exception because it ensures that other WTO Members are not faced with increased barriers to trade at any stage of the implementation process but it allows Members time to eliminate internal trade restrictions.

2 Measures Covered

(a) *Measures Adopted Upon Formation*

Article XXIV:5 states that GATT 1994 shall not prevent 'the formation of a customs union or of a free-trade area'. The Appellate Body has interpreted the word 'formation' to mean that measures imposed by WTO Members

²⁵ WTO Committee on Regional Trade Agreements, *Synopsis of 'Systemic' Issues Related to Regional Trade Agreements: Note by the Secretariat*, WT/REG/W/37 (2 March 2000) para 48(c).

that would otherwise be inconsistent with GATT 1994 do not fall within the Article XXIV:5 exception unless they are 'introduced upon the formation of a customs union'²⁶ or, presumably, an FTA. Thus, WTO-inconsistent measures that are added to the terms of an RTA after the RTA has been formed would not fall within the exception.

In some situations, this limitation may create difficulties for RTA parties. One example arose in *US – Line Pipe* in relation to safeguard measures, which are emergency actions taken to respond to particular market situations on a temporary basis.²⁷ The dispute in *US – Line Pipe* concerned a specific safeguard measure on line pipe adopted by the United States. The United States excluded imports from Canada and Mexico from the application of the safeguard measure because these three countries had agreed as a general matter, pursuant to the North American Free Trade Agreement (NAFTA), not to impose safeguard measures on each other.²⁸ Korea challenged the safeguard under several provisions of GATT 1994 and the Agreement on Safeguards.²⁹ The panel found that the line pipe measure fell within the exception of Article XXIV:5 of GATT 1994 because 'the mechanism providing for the exclusion of free-trade area partners from safeguard measures' was established upon the formation of NAFTA, even though the specific safeguard on line pipe was adopted after NAFTA's formation.³⁰ On appeal, the Appellate Body found it unnecessary to review these findings and declared them to be 'moot' and 'of no legal effect'.³¹ Therefore, although the panel's reasoning is instructive, it has no formal legal value.

The panel's approach adds a dose of pragmatism to the understanding of the word 'formation' in Article XXIV:5. Often, the parties to a customs union or an FTA will be unable to provide specifically for every conceivable eventuality upon the formation of the agreement. Therefore, a distinction should be drawn between general framework provisions introduced upon formation and specific implementing measures adopted subsequently, pursuant to the framework provisions. The exception under Article XXIV:5 should extend to the framework provisions and the implementing measures. However, to improve transparency and to allow WTO Members to scrutinise an RTA at the time of its adoption, the framework provisions

²⁶ Appellate Body Report, *Turkey – Textiles*, para 46.

²⁷ GATT 1994, art XIX:1(a); Agreement on Safeguards, arts 6–7.

²⁸ This situation also raised questions regarding the extension of the exception in Article XXIV:5 of GATT 1994 to the Agreement on Safeguards, as discussed further in section II.D.2 below.

²⁹ Panel Report, *US – Line Pipe*, para 3.1.

³⁰ *Ibid* n 128.

³¹ Appellate Body Report, *US – Line Pipe*, paras 198 and 199.

should make plain the nature of the WTO-inconsistent measures envisaged and the circumstances in which they are likely to be adopted.

(b) *Measures Necessary for Formation*

In *Turkey – Textiles*, the Appellate Body specified that Article XXIV:5 can be used as a defence for inconsistent measures adopted in connection with a customs union ‘only to the extent that the formation of the customs union would be prevented if the introduction of the measure[s] were not allowed’.³² Presumably this ‘necessity test’ would apply equally to FTAs. If applied broadly, this test would mean that an RTA can only depart from GATT 1994 rules if the departure is necessary to the formation of the RTA.

However, it is not clear whether the necessity test applies solely to inconsistencies arising from the imposition of *external* trade restrictions or also to inconsistencies arising from the elimination of *internal* trade restrictions. Although the Appellate Body drew no distinction between these types of restrictions in formulating the test, that dispute concerned an inconsistency resulting from the introduction of restrictions on the *external* trade of a customs union. In particular, Turkey introduced 19 quantitative restrictions on imports from India on the formation of a customs union with the European Union.

In *US – Line Pipe*, the panel noted the specific facts addressed in *Turkey – Textiles* and suggested that the necessity test does not apply to inconsistencies arising from the elimination of *internal* trade restrictions. The panel stated:

[T]he elimination of ‘duties and other restrictive regulations of commerce’ between parties to a free-trade area ... is the very *raison d’être* of any free-trade area. If the alleged violation of GATT 1994 forms part of the elimination of ‘duties and other restrictive regulations of commerce’, there can be no question of whether it is necessary for the elimination of ‘duties and other restrictive regulations of commerce’.³³

On appeal in *US – Line Pipe*, the Appellate Body did not specifically address this finding, but it held that the panel’s findings on Article XXIV were moot and of no legal effect.³⁴

³² Appellate Body Report, *Turkey – Textiles*, para 46. That appeal concerned a customs union rather than an FTA. However, a similar necessity test presumably applies to FTAs as the chapeau of Article XXIV:5 applies to both types of RTA.

³³ Panel Report, *US – Line Pipe*, para 7.148.

³⁴ Appellate Body Report, *US – Line Pipe*, paras 198–199.

Nonetheless, there are good reasons for confining the Appellate Body's ruling in *Turkey – Textiles* to the facts before it and, therefore, applying a necessity test only to external trade restrictions. This approach is consistent with the purpose of the exception in Article XXIV:5. As discussed above, the exception in Article XXIV:5 aims to prevent increases in the level of external trade restrictions. Therefore it makes sense to impose an additional requirement of necessity on the introduction of any such restrictions. However, as reflected in the RTA Understanding, a key purpose of the exception in Article XXIV:5 is to promote the complete elimination of internal trade restrictions. The application of a necessity test to internal trade restrictions would undermine this purpose by requiring RTA parties to demonstrate that the elimination of each and every internal restriction is necessary to the formation of the RTA.

Moreover, as explained below, under Article XXIV:8, the parties to an FTA are required only to eliminate internal restrictions on 'substantially' — but not all — trade. Therefore, under this provision, it is *never necessary* to eliminate *all* internal trade restrictions. The application of a necessity test, in this situation, could, therefore, mean that parties would be required to maintain some internal restrictions. Yet, the stated purpose of Article XXIV, as set out in the RTA Understanding, seeks precisely to secure the elimination of *all* internal trade restrictions. The application of the necessity test would, therefore, prevent parties to a customs union or an FTA achieving the objectives of Article XXIV.

Moreover, it is difficult to see how WTO Members, panels, or the Appellate Body could determine whether the elimination of a particular trade restriction among RTA parties was necessary for the formation of the RTA, or why they should have jurisdiction to review such questions. Article XXIV:8 of GATT 1994 simply requires an RTA to eliminate trade restrictions on 'substantially all' internal trade. It focuses on the *level* of internal trade restrictions rather than the *type* of trade affected. It does not prescribe which restrictions should be removed and which maintained; nor does it provide criteria in this regard. Thus, the RTA parties have discretion as to which internal trade restrictions to eliminate and in which circumstances,³⁵ provided that restrictions are eliminated on substantially all trade. It would go beyond the role of panels and the Appellate Body to second-guess such decisions.³⁶ In addition, the panel in *US – Line Pipe* gave the

³⁵ For example, Article 802.1 of NAFTA limits the exclusion of Canada and Mexico from safeguard measures to situations where imports from these countries do not account for a 'substantial share of total imports' and do not 'contribute importantly' to serious injury. Article 5.3 of the US-Israel FTA limits the exclusion of safeguard measures to situations where imports from Israel are not 'a substantial cause of the serious injury'.

³⁶ See DSU, arts 3.2 and 19.2.

following example of the practical difficulties of applying a necessity test to internal trade restrictions:

[A]ssume that an FTA eliminates duties on peanuts, but not cars. In the context of a necessity test, third countries could claim that it was not necessary to eliminate duties on peanuts to meet the 'substantially all the trade' threshold of Article XXIV:8(b), as that threshold could have been met by eliminating duties on cars. In such cases, it is difficult to imagine how a necessity requirement could ever be fulfilled.³⁷

D Exception to What? Extending the Exception Beyond GATT 1994

1 Agreement on Textiles and Clothing

On its face, the exception in Article XXIV:5 of GATT 1994 applies solely to inconsistencies with the provisions of 'this Agreement', that is GATT 1994 itself. The exception might not, therefore, justify RTA measures that are inconsistent with other WTO agreements. Remarking on this issue in a footnote in *Turkey – Textiles*, the Appellate Body observed that 'legal scholars' have taken the view that Article XXIV:5 provides an exception for inconsistencies with GATT provisions. It went on to note that the chapeau 'refers only to the provisions of the GATT 1994'.³⁸ Nonetheless, the Appellate Body considered that Article XXIV:5 could provide an exception for an inconsistency with Article 2.4 of the ATC because Article 2.4 itself permits restrictions introduced under 'relevant GATT 1994 provisions'. The Appellate Body considered that this explicit reference to GATT 1994 in Article 2.4 means that the exception in Article XXIV is 'incorporated in the ATC'.³⁹

So which WTO provisions, in which other WTO agreements, are covered by the exception in Article XXIV:5? The Appellate Body's reasoning in *Turkey – Textiles* suggests that the exception does not extend automatically to all WTO provisions. In *Turkey – Textiles*, the extension was based on an express reference, in another covered agreement, to GATT 1994. In all likelihood, other extensions will also depend on the wording and context of the relevant provisions. This approach is supported by the general interpretative note to the WTO goods agreements, found in Annex 1A of the WTO Agreement. The note states that 'in the event of a conflict' between provisions of GATT 1994 and provisions of one of the other goods

³⁷ Panel Report, *US – Line Pipe*, n 137.

³⁸ Appellate Body Report, *Turkey – Textiles*, n 13.

³⁹ *Ibid.*

agreements, the latter prevails. If the exception in Article XXIV:5 permits an RTA measure that is inconsistent with another goods agreement, a conflict exists between GATT 1994 and the other agreement. If a panel automatically applied the GATT 1994 exception to the other agreement, without examining the specific context, this would be contrary to Annex 1A of the WTO Agreement.

2 Agreement on Safeguards

One fertile area of dispute over the scope of the RTA exception in Article XXIV:5 concerns the Agreement on Safeguards.⁴⁰ Safeguard measures are imposed by WTO Members pursuant to both Article XIX of GATT 1994 and the provisions of the Agreement on Safeguards.⁴¹ Articles I, XIII, and XIX of GATT 1994, as well as Article 2.2 of the Agreement on Safeguards, require that safeguard measures be applied on a non-discriminatory, MFN basis to imports of the relevant product from all sources. In some instances, a WTO Member has excluded RTA partner countries from the application of safeguard measures, claiming that such discriminatory application is permitted under Article XXIV. This situation may raise questions regarding the type of measures that benefit from the exception in Article XXIV:5, as discussed above,⁴² and the requirement in Article XXIV:8 that RTAs eliminate internal trade restrictions on substantially all trade, as discussed below.⁴³

Another problematic aspect of this issue is whether the exception in Article XXIV:5 extends to the MFN obligation in Article 2.2 of the Agreement on Safeguards. So far, the Appellate Body has not answered this question. However, as foreshadowed above,⁴⁴ the panel in *US – Line Pipe* ruled that the Article XXIV:5 of GATT 1994 can provide a defence to Article 2.2 of the Agreement on Safeguards. The panel highlighted the ‘close interrelation between Article XIX and the Safeguards Agreement’, and the fact that ‘safeguard measures subject to the provisions of the Safeguards Agreement are understood to be Article XIX measures’.⁴⁵ It noted that Article XXIV:5 provides a defence to the MFN obligations in Articles I, XIII, and XIX of GATT 1994⁴⁶ and that it would be ‘incongruous’ if it did not also provide a defence to the MFN obligation in Article 2.2 of the Agreement on Safeguards for the same measure.⁴⁷

⁴⁰ See, eg, Joost Pauwelyn, ‘The Puzzle of WTO Safeguards and Regional Trade Agreements’ (2004) 7 *Journal of International Economic Law* 109.

⁴¹ Appellate Body Report, *Korea – Dairy*, para 77.

⁴² See section II.C.2(a) and (b) above.

⁴³ See section III.C and D below.

⁴⁴ See section II.C.2(a) above.

⁴⁵ Panel Report, *US – Line Pipe*, para 7.150.

⁴⁶ *Ibid* para 7.146.

⁴⁷ *Ibid* para 7.150.

Although the Appellate Body declared the panel's findings on Article XXIV moot and of no legal effect,⁴⁸ the panel's reasoning on this issue is both compelling and faithful to the Appellate Body's rulings in *Turkey – Textiles* and in safeguard disputes. The panel extended the exception in Article XXIV:5 to a provision of another WTO agreement on the basis of specific language in the other agreement. Moreover, the Appellate Body has already recognised that the Agreement on Safeguards and Article XIX of GATT 1994 impose a single, cumulative set of obligations on the same measures — that is, safeguard measures.⁴⁹ The link is particularly strong in the case of the MFN obligation because this same obligation is imposed in both Article 2.2 of the Agreement on Safeguards and in Articles I, XIII and XIX of GATT 1994.

A further consideration in extending the exceptions in Article XXIV of GATT 1994 to the Agreement on Safeguards is the last sentence of footnote 1 to the latter agreement, which states:

Nothing in [the Agreement on Safeguards] *prejudges* the interpretation of the relationship between Article XIX and paragraph 8 of Article XXIV of GATT 1994.⁵⁰

The panel in *US – Line Pipe* noted that this phrase deals with the relationship between *two provisions of GATT 1994* and *not* the relationship between the Agreement on Safeguards and Article XXIV. The panel, therefore, held that the footnote did not affect its conclusion that the application of Article XXIV to provisions of the Agreement on Safeguards should be determined by an examination of the Agreement on Safeguards itself, together with relevant provisions of GATT 1994.

3 Other WTO Goods Agreements

Similar questions could arise in relation to the effect of Article XXIV:5 of GATT 1994 on the provisions of other WTO agreements. For instance, a number of RTAs have adopted harmonised rules that differ from the WTO disciplines in the SPS Agreement and the TBT Agreement. Based on the existing jurisprudence on Article XXIV:5, the extension of the exception to provisions of these or other WTO agreements will depend on whether there is a 'close interrelation' between the provisions and GATT 1994.

While the approaches of the panel and Appellate Body in *US – Line Pipe* are firmly rooted in the language of Article XXIV:5, it may be questioned whether that provision, dating from GATT 1947, remains appropriate for

⁴⁸ Ibid paras 198–199.

⁴⁹ Appellate Body Report, *Korea – Dairy*, para 77.

⁵⁰ Emphasis added.

a legal framework that now comprises 12 separate agreements dealing with goods, in addition to GATT 1994. Article XXIV expresses a policy decision by WTO Members to accept the inevitable positive discrimination that RTAs create in favour of the RTA parties. If Members accept this discrimination for all of the obligations in GATT 1994, as well as for certain obligations in other WTO goods agreements that have a 'close interrelation' with GATT 1994, what reason could there be not to extend the exceptions to all obligations in the WTO goods agreements?

The legal framework for goods may be contrasted with the framework for services where there is no doubt that the RTA exception applies to all services obligations.⁵¹ Applying the RTA exception in Article XXIV:5 of GATT 1994 to only some goods-related obligations might imply the existence of a hierarchy of norms among the goods obligations, with some being subject to the exception but not others. However, it does not seem that the Members intended to establish such a hierarchy. Rather, the exception in Article XXIV:5 originally extended to all goods-related obligations — that is, to all obligations under GATT 1947. As negotiators gradually extended the number and scope of goods agreements, they did not expressly extend the exception in Article XXIV:5. In the absence of such express clarification, panels and the Appellate Body cannot apply the exception automatically to all goods-related obligations. Rather, they must strive to translate the ambiguous textual indications into a workable system of rights and obligations. The current climate of uncertainty, and possible dissatisfaction with the existing jurisprudence, may provide the necessary impetus for Members to reach a specific agreement on this question in the ongoing negotiations.

III ELIMINATING RESTRICTIONS ON TRADE WITHIN THE RTA: ARTICLE XXIV:8(A)(I) AND (B)

A *Introduction*

As already mentioned, Article XXIV:8 of GATT 1994 defines 'customs union' and 'free-trade area'. To benefit from the exception in Article XXIV:5, an RTA must meet one of these definitions. Both types of RTA are defined by the elimination of internal trade restrictions. For customs unions, this requirement is contained in Article XXIV:8(a)(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

⁵¹ GATS, art V.

constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories ...

For FTAs, the corresponding requirement is contained in Article XXIV:8(b):

duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

Thus, both customs unions and FTAs: (a) require the elimination of restrictions on 'substantially all the trade' between the RTA parties; (b) define the restrictions that must be eliminated as duties and 'other restrictive regulations of commerce' (ORRCs); and (c) expressly allow the maintenance of certain restrictions, 'where necessary', namely 'those permitted under Articles XI, XII, XIII, XIV, XV and XX' of GATT 1994.

Before turning to an examination of these three common elements, we point out a difference in these provisions regarding the origin of goods traded between RTA parties. In the case of customs unions, internal restrictions must be eliminated either on substantially all trade between the parties, or on substantially all trade in products originating in the parties. The first option is more trade-liberalising, because it entails the elimination of restrictions on trade in any goods, irrespective of where the goods originate. In contrast, the second option entails the elimination of trade restrictions only on goods originating within the customs union. In the case of FTAs, only the second of these options is available. That is, internal restrictions must be eliminated on substantially all trade 'in products originating' within the FTA.

B Measuring 'Substantially All the Trade'

1 Members' Views

The meaning of 'substantially all the trade' in Article XXIV:8 has given rise to much discussion over the years. To date, WTO Members have been unable to agree on the proportion of trade that amounts to 'substantially' all trade,⁵² or how 'all the trade' within an RTA is to be measured.⁵³

⁵² New Zealand has even suggested, in view of the many difficulties surrounding the word 'substantially', that the word should be 'removed' from Article XXIV:8: WTO Committee on Regional Trade Agreements, *Note on the Meetings of 16–18 and 20 February 1998*, WT/REG/M/16 (18 March 1998) para 115.

⁵³ WTO Committee on Regional Trade Agreements, *Coverage, Liberalization Process and Transitional Provisions in Regional Trade Agreements: Background survey by the Secretariat*, WT/REG/W/46 (5 April 2002).

However, two overlapping approaches have gained currency. First, a *qualitative* approach, which would require the elimination of restrictions with respect to every major sector of the economies of the RTA parties. Second, a *quantitative* approach, which relies on a statistical threshold, for example requiring the elimination of restrictions with respect to a predefined percentage of trade.

The qualitative approach is designed to prevent RTA parties from maintaining restrictions to protect important sectors from competition within the RTA. The rationale would seem to be that an exception to WTO rules should only be granted when the parties to a regional agreement have shown commitment to closer economic integration. If the parties exclude major economic sectors from liberalisation, that commitment is deemed lacking. If this approach were adopted, it would be likely to operate in conjunction with a quantitative criterion, and rules would be required to determine what constitutes a major economic sector.

Under the quantitative approach, one suggestion is that internal restrictions should be eliminated on 95% of all Harmonized Commodity Description and Coding System (HS) tariff lines at the six digit level. Tariff lines can be used as a criterion to ensure that liberalisation covers all possible or potential trade between the RTA parties, because all goods fall within a tariff line. However, using tariff lines may give a misleading impression of the extent to which trade has been liberalised, for instance where actual trade flows between the RTA parties are concentrated in a few tariff lines. If restrictions on these few tariff lines were maintained, a large share of current trade could escape liberalisation.⁵⁴ Conversely, a large number of tariff lines may be devoted to a small amount of actual trade. For example, around a quarter of all HS tariff lines deal with agricultural products, which may account for only a small portion of actual trade.⁵⁵

Trade flows provide an alternative to tariff lines in establishing the threshold of trade for which restrictions must be eliminated. Thus, for example, the elimination of internal restrictions could be required with respect to 95% of all trade flows between the RTA parties. However, using trade flows as a criterion is also problematic. First, actual trade flows are distorted by trade restrictions and do not necessarily reflect the likely

⁵⁴ For instance, the European Communities has pointed out that in agreements involving the Faroe Islands, 'well under 50 tariff lines accounted for about 80 per cent of the trade'. Norway, likewise, has observed that in a Faroe Islands-Norway FTA, all of the trade between the two parties was conducted under just 10 tariff lines. WTO Committee on Regional Trade Agreements, *Note on the meetings of 16-18 and 20 February 1998*, WT/REG/M/16 (18 March 1998) paras 118 and 125.

⁵⁵ WTO Committee on Regional Trade Agreements, *Note on the Meetings of 23-24 September 1998*, WT/REG/M/19 (16 October 1998) para 18.

trade volumes if restrictions were eliminated.⁵⁶ Second, difficulties arise in applying this criterion. For example, a threshold of 95 percent of all trade could be measured either as a proportion of aggregate trade flowing between the parties or as a proportion of each party's individual trade with the other. To take the simplest case, where there are only two RTA parties,⁵⁷ suppose that Country A exports to Country B are valued at US\$95 million, and Country B exports to Country A are valued at US\$5 million. Using an aggregate measure, the two countries would need to eliminate internal trade restrictions on 95% of the total trade, valued at US\$100 million. The parties would have discretion as to which part of the total trade to liberalise,⁵⁸ and they could even agree simply that Country B would eliminate all restrictions on Country A imports. In contrast, using an individual measure, each country would have to eliminate trade restrictions on 95% of the imports from the other country.

The question of how to calculate trade flows in applying a quantitative approach to 'substantially all the trade' could be of particular importance in the case of North-South agreements, where the parties may wish to liberalise trade unequally. Using an aggregate measure, developing countries might be able to benefit from elimination of restrictions on a greater share of their exports to a developed country party. Alternatively, WTO Members might consider it preferable to prescribe individual measurement, in order to prevent one RTA party from forcing another, in a weaker bargaining position, to accept a lower degree of liberalisation.

In order to measure 'substantially all the trade' between FTA parties 'in products originating' in those parties under Article XXIV:8(b), rules are required to determine whether goods 'originated' within the RTA. Such rules are also needed in connection with a customs union if the parties chose to eliminate restrictions not with respect to substantially all trade between them but only with respect to substantially all trade in products originating in the parties' territories.

Rules of origin are used to decide in which country goods are produced and, therefore, in an RTA setting, whether they qualify for a tariff preference.⁵⁹ In FTAs, the parties often adopt special rules of origin to

⁵⁶ See generally WTO Committee on Regional Trade Agreements, *Communication from Australia*, WT/REG/W/22 (30 January 1998) and Add.1 (24 April 1998). See also WTO Committee on Regional Trade Agreements, *Note on the meetings of 16–18 and 20 February 1998*, WT/REG/M/16 (18 March 1998) para 112.

⁵⁷ The situation becomes even more complicated for RTAs with three or more parties.

⁵⁸ See WTO Committee on Regional Trade Agreements, *Communication from Australia—Addendum*, WT/REG/W/22/Add.1 (24 April 1998).

⁵⁹ The WTO imposes limited disciplines on rules of origin under the Agreement on Rules of Origin.

determine which goods qualify for preferential treatment in the RTA. The preferential rules may apply much stricter qualifying conditions than the rules of origin generally used in MFN trade.⁶⁰ Thus, goods that are deemed to originate in one RTA party under the general rules of origin may not be treated as originating in that party under preferential rules of origin. Such special rules of origin may, therefore, narrow the scope of trade that is liberalised within an RTA. This has led some Members to suggest that the measurement of 'substantially all the trade' should take into account preferential rules of origin. For example, 'all the trade' within an RTA in products originating in the RTA parties could be measured using MFN rules of origin, while the proportion that is liberalised could be measured using the preferential rules of origin applying within that RTA.⁶¹

2 Interpretation in Dispute Settlement

Although the Members have yet to agree on a meaning for the term 'substantially all the trade', panels or the Appellate Body may be called upon to interpret the term in dispute settlement. So, far, neither the Appellate Body nor any panel has provided a detailed interpretation of this notion. In *Turkey – Textiles*, the Appellate Body noted that 'substantially all the trade' is not the same as all the trade, but that it 'is something considerably more than merely *some* of the trade'.⁶² Therefore, the relevant amount of trade falls somewhere between some and all trade among the RTA parties. Beyond this, the disputes provide little guidance. In order to prove that NAFTA complied with Article XXIV:8(b) in *US – Line Pipe*, the United States submitted evidence that NAFTA eliminated 'duties on 97 percent of the Parties' tariff lines, representing more than 99 percent of the trade among them in terms of volume'.⁶³ After reviewing the evidence, and without offering any views on the meaning of 'substantially all the trade', the panel held that the United States had established a *prima facie* case that NAFTA met the definition of an FTA under Article XXIV:8(b).⁶⁴ The Appellate Body took the view that it need not address this finding and declared it to be of no legal effect.⁶⁵

It is perhaps unrealistic and inappropriate to expect that panels or the Appellate Body will develop a refined formula for identifying

⁶⁰ Preferential rules of origin are not subject to the general obligations in the Agreement on Rules of Origin, although they are subject to certain transparency requirements in the Common Declaration with Regard to Preferential Rules of Origin in Annex II of that Agreement.

⁶¹ See, for instance, WTO Committee on Regional Trade Agreements, *Note on the meetings of 6–7 and 10 July 1998*, WT/REG/M/18 (22 July 1998) para 19.

⁶² Appellate Body Report, *Turkey – Textiles*, para 48 (original emphasis).

⁶³ Panel Report, *US – Line Pipe*, para 7.142.

⁶⁴ *Ibid* para 7.144.

⁶⁵ *Ibid* paras 198–199.

'substantially all the trade'. For instance, it would be difficult for a panel to find a textual basis for a finding that a precise threshold of 90 percent is never 'substantial' but that a precise threshold of 95 percent always is. If the clarification of this notion is left to panels and the Appellate Body, it is more likely that they will develop a flexible test premised on the word 'substantial', which indicates that the elimination of internal restrictions must cover a very considerable proportion of the trade between the parties. The words 'all trade' will also be important, as they identify the broad base against which internal liberalisation is to be measured. In each case, panels are likely to reach a conclusion based on the specific facts at issue, probably taking account of the qualitative and quantitative factors discussed by the Members.

C Eliminating 'Duties and Other Restrictive Regulations of Commerce'

A second question arising from the definitions of customs unions and FTAs is which trade restrictions are to be eliminated. According to Article XXIV:8(a)(i) and (b), the parties to a customs union or an FTA must eliminate duties and ORRCs on substantially all the trade within the RTA. WTO Members have frequently discussed the words 'duties and other restrictive regulations of commerce', without reaching any agreement on their meaning. Similarly, no panel or Appellate Body reports to date have interpreted these words. While the words 'substantially all the trade' dictate how much trade must be liberalised within an RTA, the words 'duties and other restrictive regulations of commerce' describe the types of restriction to be eliminated. Evidently, elimination of a broader range of restrictive regulations will result in a higher level of liberalisation within the RTA, in accordance with the purpose of the exception in Article XXIV:5.

What seems important, in determining which regulations constitute ORRCs, is not the form of a regulation, but its effect on commerce. The requirement of elimination applies only to regulations that have a 'restrictive' effect on commerce, irrespective of whether the regulation imposes duties or takes some other form. Article XXIV:8 does not state expressly what kind of restrictive effect is intended. Virtually all regulations affecting goods have some kind 'chilling' effect that restricts trade in those goods. This is equally true of border regulations, which chill imports, and marketplace regulations,⁶⁶ which chill trade in domestic and imported goods. It seems rather unlikely, though, that Article XXIV:8 was intended to encompass all regulations that have a restrictive effect on trade, however small. It is worth noting that the RTA Understanding

⁶⁶ Marketplace regulations regulate, for example, the distribution, transport, marketing or sale of goods.

refers to the 'elimination *between the constituent territories* of duties and other restrictive regulations of commerce'.⁶⁷ This suggests that the regulations to be eliminated under Article XXIV:8 are those restricting the cross-border movement of goods between the RTA parties. The focus of internal liberalisation under Article XXIV:8 is, in other words, on restrictions that adversely affect imported or exported goods, with the goal being to create a market among the parties that is border-free rather than regulation-free.

So what types of restrictions are duties or ORRCs pursuant to Article XXIV:8? By definition, border restrictions apply solely to imports, imposing restrictions on the cross-border movement of goods, and they are certainly ORRCs. These include import bans, quantitative restrictions, and the many administrative rules regulating importation. Sanitary and phytosanitary (SPS) measures prohibiting the importation of goods would also be ORRCs. ORRCs are also likely to include marketplace regulations that adversely affect imported goods, as compared with domestic goods, but such regulations would likely be already proscribed by the WTO national treatment obligation.⁶⁸

Much discussion among academics and WTO negotiators has focused on whether trade remedy measures are ORRCs. Measures adopted under Article VI (anti-dumping and countervailing measures) or XIX (safeguard measures) of GATT 1994 are not expressly identified in the bracketed phrase in Article XXIV:8, ('except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX'), which is discussed further below.⁶⁹ The exclusion of trade remedy measures from this phrase could mean that trade remedy measures are simply not ORRCs (in which case there was no need to include them in the brackets and they are not subject to the elimination requirement). However, it could also be that they are ORRCs and their exclusion from the brackets means there is no express right to maintain them (in which case they should be eliminated on substantially all the trade between the RTA parties).⁷⁰

The text of Article XXIV:8 contains little support for excluding trade remedy measures from the measures that need to be eliminated, ie duties and ORRCs. Anti-dumping and countervailing duties are described as 'duties' in Articles II and VI of GATT 1994, as well as in the Anti-Dumping Agreement and the SCM Agreement. These 'duties' are imposed, in addition to ordinary customs duties, on the importation of products.

⁶⁷ Emphasis added.

⁶⁸ GATT 1994, art III.

⁶⁹ See section III.D.2 below.

⁷⁰ WTO Negotiating Group on Rules, *Compendium of Issues Related to Regional Trade Agreements* — Background Note by the Secretariat (Revision), TN/RL/W/8/Rev.1 (1 August 2002) para 74.

Moreover, the very purpose of these duties is to restrict imports of specific products. Under Article XIX of GATT 1994, safeguard measures involve the modification or withdrawal of a market access concession for imported goods. The purpose of safeguard measures is, therefore, also to restrict imports. The restriction on access takes the form of either a duty or a quantitative restriction. Again, there is little reason to suppose that safeguard measures are not ORRCs.⁷¹

D Internal Restrictions That May Be Maintained

1 Restrictions on an 'Insubstantial' Portion of Trade

Under Article XXIV:8, the RTA parties need not eliminate all ORRCs; they must simply eliminate ORRCs on 'substantially all the trade' between the parties. On the remaining portion of trade, the parties are entitled to retain all ORRCs of any type (provided that they are not otherwise inconsistent with WTO rules), including trade remedy measures and other measures not listed in the brackets. But difficult questions remain.

If the RTA parties decide to retain the possibility of imposing trade remedy measures on each other, the RTA is likely to include a general authority for each party to impose such measures in specific cases in the future. This general authority, of itself, might be regarded as an ORRC on all the products that are potentially subject to trade remedy measures at a later stage. In this case, restrictions would be deemed to remain on all the products potentially subject to trade remedy measures. To comply with the requirement to eliminate restrictions on substantially all the trade, RTA parties would have to confine the general authority to a defined group of products representing no more than an insubstantial portion of trade.

Alternatively, it could be argued that the general authority does not, in fact, restrict commerce; it merely enables a potential future restriction, which might never be realised. On that view, the general authority is not an ORRC and need not be limited to particular products representing an insubstantial portion of trade. Rather, specific measures imposed pursuant to the general authority are ORRCs and must be limited to such a portion.⁷² This approach is also problematic. It would leave undefined and uncertain

⁷¹ The panel in *Argentina – Footwear* assumed that safeguard measures are 'duties and other restrictive regulations of commerce' under Article XXIV:8; paras 8.96–8.97. The Appellate Body reversed the panel's findings on Article XXIV: Appellate Body Report, *Argentina – Footwear (EC)*, para 110. However, this aspect of the panel's findings on Article XXIV was not examined by the Appellate Body nor specifically declared to be an erroneous interpretation of Article XXIV:8.

⁷² This seems to be the approach suggested in Panel Report, *Argentina – Footwear (EC)*, para 8.97. See above n 71.

the number and type of ORRCs that could be imposed within the RTA and, hence, the proportion of trade subject to ORRCs. As a result, the consistency of the RTA with the conditions of the exception in Article XXIV:5 of GATT 1994 would vary, depending on the number and extent of trade remedy measures imposed at any given time. It would be impossible to state definitively, based merely on the RTA itself, whether it was justified under the exception.

2 Other Restrictions Expressly Permitted

Although Articles XXIV:8(a)(i) and (b) state that, in a customs union or an FTA, restrictive regulations of commerce must be eliminated on substantially all internal trade, both paragraphs create an exception to this requirement, 'where necessary', for 'those' ORRCs 'permitted under Articles XI, XII, XIII, XIV, XV and XX'.

Some WTO Members have suggested that the bracketed list of measures is illustrative only. In other words, measures apart from those 'permitted under Articles XI, XII, XIII, XIV, XV and XX', such as trade remedy measures, may also be implicitly included in the list and maintained within an RTA.⁷³ This argument has not won the support of all Members. In any case, since the bracketed list provides an exception to the general rule of elimination of ORRCs, it would normally be interpreted in a manner precluding the addition of other measures. This approach is consistent with the Appellate Body's statement in *Turkey – Textiles* that the bracketed phrase allows parties to maintain measures 'otherwise permitted under Articles XI through XV and under Article XX of the GATT 1994'.⁷⁴ While not a definitive ruling on this issue, this statement suggests that the Appellate Body would read the bracketed phrase as containing an exclusive list of the ORRCs that may be maintained in an RTA.⁷⁵

In *Turkey – Textiles*, the Appellate Body recognised that this exception to the general requirement of elimination of ORRCs offers 'some flexibility' to the parties to a customs union (and presumably also an FTA) to maintain

⁷³ WTO Negotiating Group on Rules, *Compendium of Issues Related to Regional Trade Agreements — Background Note by the Secretariat (Revision)*, TN/RL/W/8/Rev.1 (1 August 2002) para 75. The WTO Secretariat has observed that '[t]he drafting history does not indicate why Articles XI-XV and XX were included in the list of exceptions while others, in particular Article XIX, were not included': WTO Committee on Regional Trade Agreements, *Systemic Issues Related to 'Other Regulations of Commerce': Background Note by the Secretariat (Revision)*, WT/REG/W/17/Rev.1 (5 February 1998) para 6.

⁷⁴ Appellate Body Report, *Turkey – Textiles*, para 48.

⁷⁵ It may be that certain measures permitted under Article XXI of GATT 1994 in connection with essential security interests are also permitted by Article XX, perhaps as necessary to protect human, animal or plant life or health, or even public morals.

certain types of ORRCs.⁷⁶ However, the Appellate Body cautioned that this flexibility is limited by the requirement that ORRCs be eliminated with respect to substantially all internal trade. In addition, the exception applies only ‘where necessary’, although the text provides no guidance as to when it is necessary to maintain restrictions. In *Turkey – Textiles*, the Appellate Body developed and applied a necessity test to the exception for RTAs in Article XXIV:5 of GATT 1994.⁷⁷ A similar test could also be applied to the bracketed phrase in Article XXIV:8. In that context, to the extent that the formation of an RTA would be prevented if an ORRC listed in that phrase were eliminated, it could be regarded as ‘necessary’ to maintain the ORRC.

An interesting and, as yet, unresolved question is whether products subject to ORRCs listed in the brackets are part of the ‘substantial’ or ‘insubstantial’ portion of trade. The question can be illustrated by example. Suppose a WTO Member maintains quantitative restrictions, under Article XII, on imports of all steel products from partner countries in an RTA. No duties or other restrictions are imposed on steel imports. In measuring whether ORRCs have been eliminated on substantially all the trade in the RTA, should steel products be counted as trade on which ORRCs have been eliminated (the substantial portion of trade) or as trade on which ORRCs have not been eliminated (the insubstantial portion of trade)?

The straightforward — and stricter — view is that trade in any product subject to an ORRC has not been liberalised, and the product cannot form part of the substantial portion of trade on which ORRCs have been eliminated. On this view, the substantial portion of trade is confined to products that are subject to no ORRCs at all; conversely, a product that is subject to any ORRC, including an ORRC listed in the brackets, must form part of the insubstantial portion of trade.⁷⁸

This reading is, however, problematic. The list of ORRCs in brackets includes, among others, restrictions maintained pursuant to Article XX of GATT 1994. Article XX provides a general exception to all GATT 1994 obligations. In certain circumstances, Article XX allows Members to promote governance priorities — such as public health and environmental

⁷⁶ Appellate Body Report, *Turkey – Textiles*, para 48. The Appellate Body was examining a case involving a customs union and not an FTA. However, the text of Article XXIV:8 is the same in this regard for customs unions and FTAs.

⁷⁷ See section II.C.2.b above.

⁷⁸ It is not clear whether the advocates of this approach take the view that the only restrictive regulations that may be applied to any product are those mentioned in the brackets. Contrary to this view, we have suggested that the parties are free to retain any restrictive regulations they wish on products representing an insubstantial portion of trade because Article XXIV:8 requires only the elimination of restrictions on the substantial portion of trade.

protection — that conflict with WTO rules. WTO-consistent SPS measures are also covered by Article XX⁷⁹ and, in all likelihood, so are most WTO-consistent technical barriers to trade (TBTs). There is broad recognition in the WTO agreements, and among WTO Members, that Members should have discretion to pursue these other priorities, subject to the conditions governing the exceptions to WTO rules. However, if a product subject to health restrictions permitted by Article XX necessarily formed part of the insubstantial portion of trade on which ORRCs had not been eliminated, this would constrain WTO Members' right to pursue health objectives. In a customs union or an FTA, a WTO Member would be able to promote health only through internal restrictions on the 'insubstantial' group of products. As well as being questionable in terms of State sovereignty, this reading of Article XXIV:8 would be at odds with the text of Article XX. Article XX(b) states that 'nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures... necessary to protect human, animal or plant life or health'. If Article XXIV:8 of GATT 1994 meant that Article XX health measures could only be maintained on the insubstantial portion of trade, that interpretation would 'prevent' the adoption or enforcement of health measures on 'substantially all the trade', contrary to Article XX.

An alternative reading follows from the structure of Articles XXIV:8(a)(i) and (b). These two sub-paragraphs require that an RTA eliminate all ORRCs — except those bracketed — on substantially all trade. The bracketed exception is located immediately after the phrase 'duties and other restrictive regulations of commerce' and, together with this phrase, defines the universe of restrictions that must be eliminated with respect to substantially all trade. Thus, for products comprising substantially all trade, all ORRCs must be eliminated except those listed in the brackets. This reading, therefore, creates, three categories of product under Article XXIV:8:

- First, products that are subject to no ORRCs at all. These products form part of the 'substantial' portion of trade with respect to which all ORRCs have been eliminated.
- Second, products that are subject to no ORRCs, except for one or more of those listed in the brackets. These products also form part of the 'substantial' portion of trade with respect to which ORRCs, other than those listed in the brackets, have been eliminated.
- Third, products that are subject to ORRCs that are not listed in the brackets. These products must represent no more than an

⁷⁹ See SPS Agreement, art 2.4.

‘insubstantial’ portion of trade, with respect to which ORRCs need not be eliminated. These products may also be subject to ORRCs listed in the brackets.

Under this reading, WTO Members would be entitled to maintain, ‘where necessary’, any of the ORRCs listed in the brackets with respect to any product. In addition, they would be entitled to maintain any ORRCs with respect to an insubstantial portion of trade. This reading of Article XXIV:8 would, therefore, avoid the problem of constraining Members from maintaining measures permitted under Article XX.

IV RESTRICTIONS ON THE EXTERNAL TRADE OF THE RTA

A *Introduction*

As we have seen in the previous section of this chapter, Article XXIV:8 of GATT 1994 imposes certain conditions on the restrictions imposed by RTA parties on trade within the RTA. In addition, as we shall see in the following sections, Article XXIV of GATT 1994 imposes two conditions on the restrictions applied by RTA parties in the external trade of the RTA.

First, under Article XXIV:8(a)(ii), the definition of a customs union requires each of the parties to the union to apply ‘substantially the same duties and other regulations of commerce to the trade of territories not included in the union’.⁸⁰ This condition applies only to customs unions and not to FTAs.

Second, under Articles XXIV:5(a) and (b), an RTA will not qualify for the RTA exception under Article XXIV:5 if, broadly speaking, the ‘duties and other regulations of commerce’ imposed by the RTA parties on other WTO Members are higher or more restrictive than before the RTA was formed. The precise character of this condition differs for customs unions and FTAs. For customs unions, the condition is framed as follows under Article XXIV:5(a):

[T]he duties and other regulations of commerce imposed at the institution of [a customs union] in respect of trade with [WTO Members] not parties to such union ... 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 ...

⁸⁰ This requirement is expressly subject to Article XXIV:9, which relates to preferences in respect of import duties or charges as described in GATT 1994, art 1:2.

For FTAs, the condition is contained in Article XXIV:5(b):

[T]he duties and other regulations of commerce maintained in each [of] the constituent territories and applicable at the formation of [an FTA] to the trade of [WTO Members] not included in such area ... 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...

Sub-paragraphs 5(a), 5(b), and 8(a)(ii) of Articles XXIV all impose conditions on the 'duties and other regulations of commerce' imposed by RTA parties on external trade. We examine the meaning of these words before turning to the specific requirements of the different provisions.

B The Meaning of 'Duties and Other Regulations of Commerce'

1 Structure and Context of the Relevant Provisions

In our view, it makes sense to interpret the words 'duties and other regulations of commerce' consistently in sub-paragraphs 5(a), 5(b), and 8(a)(ii) of Articles XXIV, mindful of the different context in which they appear.

The words 'duties and other regulations of commerce' in sub-paragraphs 5(a), 5(b), and 8(a)(ii) of Articles XXIV are reminiscent of the words 'duties and other restrictive regulations of commerce' in sub-paragraphs 8(a)(i) and 8(b) of Article XXIV, examined earlier in the context of the conditions imposed on internal trade restrictions. The key difference is that the word 'restrictive' is absent in the context of external trade. However, although this is not formally part of the definition of 'other regulations of commerce' (ORCs), sub-paragraphs 5(a) and 5(b) of Article XXIV are concerned with the 'restrictiveness' of ORCs.

Sub-paragraphs 5(a) and 8(a)(ii) form a coherent pair, both dealing with customs unions. Under sub-paragraph 8(a)(ii), the parties to a customs union must 'substantially' harmonise duties and ORCs applied to the trade of countries that are not party to the RTA (whether or not they are WTO Members); sub-paragraph 5(a) requires that the newly harmonised ORCs, plus any remaining un-harmonised ORCs, applied in respect of trade with WTO Members that are not party to the RTA, be no more restrictive than the ORCs previously applied in respect of such trade. Thus, the ORCs described in sub-paragraph 5(a) (i.e. ORCs applied to WTO Members) form a subset of the ORCs that must be harmonised under sub-paragraph 8(a)(ii) (i.e. all ORCs). Sub-paragraph 5(b) relates to FTAs

and, like sub-paragraph 5(a), it addresses ORCs applied in respect of trade with WTO Members that are not party to the RTA. In the remainder of the discussion in this section of the meaning of ‘duties and other regulations of commerce’, we use the words ‘external trade’ or ‘trade with third countries’ as a convenient way of referring to the trade of countries that are not party to the RTA (in the context of Article XXIV:8(a)(ii)) and to trade with WTO Members that are not party to the RTA (in the context of Article XXIV:5(a) and (b)).

2 Examples of Regulations of Commerce

RTA parties could impose various measures that could potentially constitute ORCs, including:

- border measures regulating either the import of goods from third countries or the export of goods to third countries; and
- marketplace measures that may be applicable: solely to goods of third countries; to goods of both third countries and RTA parties; or solely to goods of RTA parties.

(a) *Border Measures*

It seems clear, and relatively uncontroversial, that the ORCs relevant to sub-paragraphs 5(a), 5(b), and 8(a)(ii) of Article XXIV include border measures applied to imports from third countries, as these measures are certainly imposed on, or applied to, external trade. These measures include customs duties and similar charges, import prohibitions, quantitative restrictions, and administrative rules regulating importation. Administrative rules might include rules of origin used to distinguish between imports of goods originating in an RTA party and those originating in a third country, and prohibition of imports from third countries that do not comply with certain SPS or TBT standards. Moreover, these measures are ORCs whether they are applied individually by one RTA party or, in the case of a customs union, by all parties.

Border measures that restrict exports from RTA parties to third countries are more problematic. During the Uruguay Round, one proposal was that the words ‘duties and other regulations of commerce’ should be interpreted to cover ‘all border measures taken in connection with importation or exportation which have a differential impact on imported products as compared to domestic products’.⁸¹ This proposal was rejected

⁸¹ WTO Committee on Regional Trade Agreements, *Systemic Issues Related to ‘Other Regulations of Commerce’: Background Note by the Secretariat (Revision)*, WT/REG/W/17/Rev.1 (5 February 1998) para 10.

due to, among other things, the inclusion of the word 'exportation'. This might suggest that the negotiators did not agree that ORCs included export measures.

A further difficulty with interpreting ORCs as including border measures on exports is that such measures are generally applied by RTA parties to their own goods when destined for third country markets⁸² and therefore cannot be described as being applicable or applied 'to the trade of' third countries within the meaning of Articles XXIV:5(b) and 8(a)(ii). However, in the context of customs unions, Article XXIV:5(a) refers to measures 'imposed ... in respect of trade *with*' third countries. This language might be broad enough to encompass export measures. This could mean that, on the one hand, export measures are not relevant to the determination under Article XXIV:8(a)(ii) of whether the parties to a customs union apply substantially the same ORCs to other countries, nor to the determination under Article XXIV:5(b) of whether the parties to an *FTA* impose higher or more restrictive ORCs on other Members; but, on the other hand, export measures are relevant to the determination under Article XXIV:5(a) of whether the parties to a *customs union* impose higher or more restrictive ORCs on other Members. It is unclear whether the drafters intended this distinction. In that respect, the RTA Understanding requires that the evaluation of ORCs, under Article XXIV:5(a), be based on '*import* statistics' for goods originating in third countries, and does not refer to 'export' statistics. This indicates that Members have resolved the textual differences between Articles XXIV:5(a), 5(b) and 8(a)(ii) in favour of an assessment of border measures on imports from, but not exports to, third countries.

(b) *Marketplace Measures*

During the Uruguay Round, a second proposal was for 'duties and other regulations of commerce' to be interpreted as covering 'all duties and charges and measures imposed on or in connection with importation or exportation'.⁸³ This proposal was also rejected, primarily because of differing opinions as to whether ORCs include internal measures such as sales taxes and price controls. In the end, no agreement was reached on an authoritative interpretation of 'duties and other regulations of commerce', and no explicit guidance was included as to whether these words cover internal or 'marketplace' measures.

⁸² Export measures may also restrict the re-exportation of (processed) goods imported from third countries.

⁸³ WTO Committee on Regional Trade Agreements, *Systemic Issues Related to 'Other Regulations of Commerce': Background Note by the Secretariat (Revision)*, WT/REG/W/17/Rev.1 (5 February 1998).

The Appellate Body has read Article XXIV:8(a)(ii) as requiring the parties to a customs union to adopt 'a common external trade regime'.⁸⁴ In other words, it appears to be assumed that parties are not obliged by Article XXIV:8(a)(ii) to harmonise internal marketplace measures (in addition to eliminating internal restrictions on trade under Article XXIV:8(a)(i)). This approach is supported by the context and purpose of Article XXIV:8(a)(ii). Read together with the chapeau of Article XXIV:8, subparagraph 8(a)(ii) states that a 'customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that ... substantially the same duties and other regulations of commerce are applied ... to the trade of territories not included in the union'. The use of the word 'customs' in the chapeau indicates that the provision focuses on border measures. Moreover, it would be rather intrusive if WTO rules required parties to apply 'substantially the same' marketplace measures on goods, whether such a requirement was limited to goods from third countries or extended to goods from within the RTA. Such a rule would be particularly broad, given that Article XXIV:8(a)(ii) is not limited to 'restrictive' regulations of commerce, and it would also not necessarily further the purpose of maximising the liberalising effects of the RTA on trade between RTA parties and minimising the trade restrictive effects on other WTO Members.

The language of Articles XXIV:5(a) and (b) suggests that the ORCs that must not be 'higher or more restrictive' do not include marketplace measures. In relation to customs unions, as already noted, Article XXIV:5(a) refers to ORCs imposed 'in respect of trade with' other WTO Members. Thus, the focus is on trade between an RTA party and another Member, rather than on trade within the RTA party. In relation to FTAs, Article XXIV:5(b) refers to ORCs 'maintained in ... and applicable ... to the trade of' other WTO Members. This wording might more easily extend to marketplace measures. However, the use of the word 'trade' (as opposed to 'goods') may well signify that the focus is not on the treatment of goods of other Members within the RTA but on the treatment of such goods at the border.

Some Members have argued that certain marketplace measures imposed by RTA parties solely on goods originating within the RTA might restrict external trade and therefore be relevant ORCs under these three subparagraphs.⁸⁵ Examples of such measures, drawn from existing RTAs,

⁸⁴ Appellate Body Report, *Turkey – Textiles*, para 49.

⁸⁵ WTO Committee on Regional Trade Agreements, *Note on the Meetings of 6–7 and 10 July 1998*, WT/REG/M/18 (22 July 1998) paras 40–46.

include the application of lower SPS or TBT standards⁸⁶ on internal RTA trade or the replacement of anti-dumping measures within the RTA with competition rules.⁸⁷ These harmonised rules apply solely to goods from RTA parties; the normal WTO rules apply to goods from third countries.⁸⁸

It is difficult to know how to treat measures that apply solely to goods from RTA parties but may have a distortive effect on trade with third countries. ORCs are described as measures 'imposed ... in respect of' (Article XXIV:5(a)), 'applicable ... to' (Article XXIV:5(b)), or 'applied ... to' (Article XXIV:8(a)(ii)) the relevant trade. On one view, the verbs 'impose' and 'apply' suggest that relevant ORCs are measures that directly regulate trade with third countries and not measures that merely have an indirect effect on trade with third countries. This would suggest that marketplace measures 'imposed' only on goods from RTA parties are not ORCs and, therefore, do not need to be harmonised in customs unions (under Article XXIV:8(ii)) or included in determining the level of restrictions on external trade in any RTA (under Articles XXIV:5(a) and (b)). Moreover, these harmonised rules arise from internal liberalisation within the RTA, which some have asserted means that they should not be regarded as barriers to trade with third countries.⁸⁹ However, it is arguably difficult to reconcile this approach with the twin purpose of the RTA exception in Article XXIV:5, given that these harmonised rules may well distort or restrict trade from third countries.

C Substantially the Same External Restrictions in Customs Unions: GATT Article XXIV:8(a)(ii)

Article XXIV:8(a)(ii) requires the parties to a customs union to apply 'substantially the same duties and other regulations of commerce ... to the trade of territories not included in the union'. This requirement has been

⁸⁶ The application of two different SPS or TBT regimes — one for internal trade and another for external trade — may mean that the external regime is inconsistent with the SPS or TBT Agreement. For instance, if more stringent rules are applied externally than internally, that could well indicate that the external rules are more trade-restrictive than is necessary or that different restrictions are being applied in similar circumstances. See SPS Agreement, arts 5.5, 5.6 and 6.1 and TBT Agreement, art 2.2.

⁸⁷ See WTO Committee on Regional Trade Agreements, *Inventory of Non-Tariff Provisions in Regional Trade Agreements: Background Note by the Secretariat*, WT/REG/W/26 (5 May 1998).

⁸⁸ Canada has argued that preferential rules of origin cannot be ORCs because they are directed to the internal trade of the RTA and not the external trade (WTO Committee on Regional Trade Agreements, *Note on the Meetings of 6–7 and 10 July 1998*, WT/REG/M/18 (22 July 1998) para 28). However, it can also be argued that preferential rules of origin apply equally to all goods in order to determine their origin, even though the result will be preferential treatment solely for goods treated as originating in the RTA.

⁸⁹ See WTO Committee on Regional Trade Agreements, *Note on the Meetings of 3–5 November 1997*, WT/REG/M/14 (24 November 1997) para 8.

described as creating 'a common external trade regime' or 'a common commercial policy'.⁹⁰ To achieve this, the parties must harmonise their respective external trade rules regulating trade with third countries; but to what extent must these restrictions be harmonised?

Discussions among Members have not focused on the meaning of 'substantially the same'. However, in the event of agreement on the meaning of 'substantially all the trade', the criteria adopted might also apply, *mutatis mutandis*, to the term 'substantially the same'. In dispute settlement, in *Turkey – Textiles*, the panel indicated that Article XXIV:8(a)(ii) describes 'a situation where constituent members have 'comparable' trade regulations having similar effects with respect to trade with third countries'.⁹¹ The Appellate Body rejected this interpretation,⁹² suggesting that the word 'substantially' means 'something closely approximating "sameness"'.⁹³ Nevertheless, it stated that parties have 'a certain degree of flexibility' to retain individual restrictions on external trade.⁹⁴ They are not required to harmonise all external trade restrictions or to adopt an identical external trade regime.⁹⁵ Despite these statements by the Appellate Body, certain questions remain as to how to determine whether the parties to any particular customs union apply substantially the same duties and ORCs to other countries. Adopting a case-by-case approach, relevant factors could include: the number of ORCs that are fully or partially harmonised, as compared with the number of un-harmonised ORCs; the degree of partial harmonisation; and the products and value of trade affected by these different restrictions.

In order to harmonise external ORCs upon the formation of a customs union, a party to the union may need to increase a specific duty beyond the bound rate specified in its Schedule of Concessions under Article II of GATT 1994. In that event, Article XXIV:6 requires the party to enter into negotiations with affected Members following the procedure set forth in Article XXVIII of GATT 1994. Essentially, these negotiations are directed towards modification or withdrawal of concessions by affected Members⁹⁶ in order to 'maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in [GATT 1994] prior to such negotiations'.⁹⁷ The obligation in Article XXIV:6 to re-

⁹⁰ Appellate Body Report, *Turkey – Textiles*, paras 49 and 50; Panel Report, *Turkey – Textiles*, para 9.148.

⁹¹ Panel Report, *Turkey – Textiles*, para 9.151.

⁹² Appellate Body Report, *Turkey – Textiles*, para 50.

⁹³ *Ibid.*

⁹⁴ *Ibid.*

⁹⁵ *Ibid.* para 49.

⁹⁶ GATT 1994, art XXVIII:1.

⁹⁷ GATT 1994, art XXVIII:2.

negotiate concessions arises solely where a party needs to increase a specific *duty*. Article XXIV does not provide any procedures for negotiating compensation where a party needs to make other ORCs more restrictive.

Following the enlargement of the European Communities from 15 to 25 Member States on 1 May 2004, negotiations under Article XXIV:6 commenced. The European Communities recently extended the deadline for affected Members to withdraw concessions as a result of the withdrawal of concessions by certain new European Communities Member States in connection with the enlargement.⁹⁸

D External Restrictions Not Higher: Article XXIV:5

1 Customs Unions: Article XXIV:5(a)

Article XXIV:5(a) of GATT 1994 states that the duties and other regulations of commerce imposed 'at the institution of' a customs union in respect of trade with other WTO Members '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'. This provision therefore requires a comparison of the ORCs imposed before and after the institution of the customs union. Before forming the union, each party applies its own ORCs on trade with other Members. After forming the union, the parties largely replace these individual trade regimes with a common external trade regime. In keeping with the purpose of the RTA exception, the requisite comparison aims to ensure that the new external trade regime of the union does not raise barriers to trade with other Members.

First, the comparison requires an assessment of 'the general incidence of the duties and other regulations of commerce applicable in the constituent territories prior to the formation of' the customs union.⁹⁹ The term 'general incidence' suggests a focus on the cumulative or combined effect of all ORCs imposed by the RTA parties rather than the specific effects of any individual ORC or the ORCs imposed by one RTA party. In any case, it would be difficult to compare specific ORCs before and after formation of the customs union because they are likely to be replaced by different ORCs under the new common external trade regime.

Second, the comparison requires an assessment of the 'duties and other regulations of commerce imposed at the institution of' the customs union.

⁹⁸ WTO Council for Trade in Goods, *Communication from the European Communities: Article XXIV:6 negotiations; Enlargement of the European Union*, G/L/695 (30 September 2004).

⁹⁹ Emphasis added.

This includes all harmonised ORCs, as well as any un-harmonised ORCs that the parties to the union continue to apply on an individual basis. Such ORCs are not to be 'on the whole ... higher or more restrictive' than before. The words 'on the whole', like the words 'general incidence', demonstrate that the comparison is based on the overall, cumulative impact of the ORCs and not on specific ORCs. As a result, certain specific ORCs imposed by one or more RTA parties may be more burdensome than before, while others may be less burdensome. However, if the ORCs 'as a whole' are more burdensome than before, the customs union cannot benefit from the RTA exception in Article XXIV:5.

As regards 'duties and charges' the RTA Understanding provides a methodology for determining their cumulative impact before and after the formation of the customs union, based on 'an overall assessment of weighted average tariff rates and of customs duties collected'. Paragraph 2 of the RTA Understanding states:

This assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin. The Secretariat shall compute the weighted average tariff rates and customs duties collected in accordance with the methodology used in the assessment of tariff offers in the Uruguay Round of Multilateral Trade Negotiations. For this purpose, the duties and charges to be taken into consideration shall be the applied rates of duty.

As regards ORCs other than duties and charges, the RTA Understanding is less explicit. Paragraph 2 recognises that for the 'overall assessment' of ORCs 'for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required'. This general guidance falls short of a methodology and leaves open precisely how to assess the impact of these ORCs. This process may be difficult because, unlike duties and charges, these restrictions do not take the form of a fixed amount or percentage that is applied to specific products.

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

Like Article XXIV:5(a), sub-paragraph 5(b) calls for a comparison between two sets of ORCs: those 'existing' prior to the formation of the FTA, and those 'applicable' at the formation of the FTA. For customs unions, we saw that the comparison under Article XXIV:5(a) is between the 'general incidence'

of all ORCs applied before and after the formation of the union. For FTAs, Article XXIV:5(b) calls for a comparison between the ORCs applied after the formation of the FTA and the 'corresponding' ORCs applied before formation. The use of the word 'corresponding' suggests that specific ORCs should be compared as they applied before and after the formation of the FTA.

This view is consistent with the nature of economic integration in FTAs. As with parties to customs unions, FTA parties must eliminate most 'duties and other restrictive regulations of commerce' on substantially all internal trade. However, as stated above, FTA parties have no obligation to adopt common rules for external trade, and parties to an FTA typically continue to impose their own external trade regimes.¹⁰⁰ Therefore, Article XXIV:5(b) prevents an FTA party from using the formation of an FTA as an opportunity to increase the burden of any individual ORC it imposes on external trade. In Article XXIV, such an increase in burden is essentially deemed unnecessary to the formation of an FTA and is inconsistent with the purpose of Article XXIV of minimising the restrictive effects of RTAs on external trade.

Article XXIV:6 envisages increases in specific bound rates upon the formation of a customs union and provides a procedure for negotiating a 'compensatory adjustment' for the affected Member. In contrast, no provision in Article XXIV envisages any increase in specific duties upon the formation of an FTA. This supports the view that a WTO Member may not make any ORC more burdensome upon the formation of an FTA. Nevertheless, other provisions of GATT 1994 or other covered agreements could conceivably provide a justification for the introduction of new restrictions by FTA parties. For instance, if the parties to an FTA decide to harmonise the SPS/TBT framework within the RTA and, in the process, one or more of the parties introduces new SPS measures or TBTs, the parties could justify the new restrictions under the SPS Agreement or the TBT Agreement, even if these restrictions would normally be regarded as relevant ORCs under Article XXIV:5(b). The introduction on the formation of an FTA of a new ORC that is justified by other WTO provisions should not prevent the FTA concerned from benefiting from the RTA exception under Article XXIV:5 — WTO rules entitle the Member to adopt the ORC whether or not it joins the RTA.

V CONCLUSION

In a global trading system, where RTAs have become a central tool of trade policy, and where they are growing rapidly in number and

¹⁰⁰ There may be situations where the formation of an FTA does result in modification to the external trade regimes of the parties. For instance, the parties to an FTA may harmonise certain internal restrictions, such as SPS measures, and in consequence modify the corresponding external restriction.

complexity, the exception in Article XXIV:5 of GATT 1994 plays a crucial role in ensuring coherence between multilateral and regional trade policy. We have noted that this exception seeks to ensure that RTAs work to the benefit of the global trading system by promoting a net increase in trade liberalisation. Yet questions remain on almost every issue of importance concerning this exception.¹⁰¹ Without answers to these questions, the value of Article XXIV in shaping regional trade policy is diminished. Moreover, the risk that RTAs work to undermine trade liberalisation at the multilateral level increases. In this chapter, we have explored some of the questions surrounding Article XXIV, evaluating possible options, always keeping in mind the underlying purpose of the RTA exception. We have examined the views expressed by Members, panels, and the Appellate Body, as well as the text of WTO agreements. We have also drawn on the way RTAs work in practice. The conclusion must be that Article XXIV is mired in doubt. Until the WTO makes further progress in this area, the WTO-consistency of most RTAs will be uncertain and Members will have difficulty determining the best way of structuring RTAs in a WTO-consistent fashion.

¹⁰¹ For example, does the exception extend to GATT-inconsistencies arising from the elimination of internal trade restrictions only if these inconsistencies were necessary to the formation of the RTA? Does it justify a departure from the obligation under the Agreement on Safeguards to impose safeguards on all imports of the relevant product from all sources? How should 'substantially all the trade' between the RTA parties be measured in assessing whether internal trade restrictions have been sufficiently reduced? Do the parties to a customs union have to harmonise not only border measures but also marketplace measures applied to goods of other Members?