



WORLD TRADE INSTITUTE

MILE 2004 PROGRAM

MASTERS IN INTERNATIONAL LAW AND ECONOMICS

**“THE LEGAL EFFECTS OF REGIONAL TRADE AGREEMENTS UNDER
THE GATT/WTO”**

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SEPTEMBER 28, 2004

*In partial fulfillment of the requirements of the Masters in Law and Economics Program
of the World Trade Institute*

Undertaking

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Marina Foltea

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TABLE OF ACRONYMS

AB	Appellate Body
AD	Anti-dumping
CRTA	Committee on Regional Trade Agreements
CU	Customs Union
DSU	Dispute Settlement Understanding
EEC	European Economic Community
EIA	Economic Integration Arrangement
FTA	Free Trade Agreement
GATT	General Agreement on Trade and Tariffs
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
MFN	Most-Favored Nation
ORCs	Other Regulations of Commerce
ORRCs	Other Restrictive Regulations of Commerce
PTA	Preferential Trade Agreements
RA	Regional Agreement
RTA	Regional Trade Agreement
SAT	Substantially All the Trade
VCLT	Vienna Convention on the Law of the Treaties
VERs	Voluntary Export Restraints
WTO	World Trade Organization

ABSTRACT

The conclusions of RTAs are surging again after almost a decade of calmness, partly due to the lack of progress in the multilateral negotiations, failure of Cancun being the latest example. The proliferation of RTAs is criticized for leaving less and less scope for MFN as envisaged in the GATT and as Johnson put it, the members left outside may no longer be “entitled to decent treatment as one the paid-up member of the club”(Johnson, 1976, p.30). The current discipline of RTAs, Article XXIV of GATT is criticized for its loopholes and vagueness thereby granting large discretions on RTAs members as to their implementation.

In this context, this thesis analyses the systemic and procedural issues in implementation of GATT Article XXIV. The General Agreement on Trade in Services (GATS) contains in its Article V a provision similar to GATT Article XXIV and a few issues relating to its implementation too will be analyzed.

Similarly, the role of the WTO dispute settlement mechanism in assessing the RTAs compliance with GATT Article XXIV is also taken up. Although the systemic issues have been discussed at length by the WTO members, there is no agreement up until now on how to read the requirements envisaged in GATT Article XXIV. Thus, the strengthening of the GATT Article XXIV implementation must start with the clarification of the internal and external trade requirements which are the most debated. In addition, it also examines how the terms contained in GATT Article XXIV could be clarified in light of the Vienna Convention on the Law of Treaties.

The economic analyses of a number of empirical papers still support the idea that regionalism diverts trade more than it creates, though one can hardly argue any more that regionalism by definition is an obstacle to freer trade in light of the available

evidence. The legal test contained in Article XXIV only tangentially, if at all, reflects the concerns of modern economic analysis. It essentially cares about one thing: how to make deviations from the MFN principle truly exceptional? In doing that, it imposes difficult on their face, conditions to meet to any WTO Member aspiring to regionalism. These conditions however do not have directly anything to do with welfare effects as a result of the creation of the RTA.

Currently the incentives to go regional are found more on political side and economics is something to be calculated later.

In conclusion although the recent advancement of economic theory can provide tools to analyze the welfare impact of an RTA, what is important is to revise the voting procedure with the CRTA and to come up with clearly defined guidance as to its role in assessing the compatibility of RTAs with the WTO provisions. An equally important issue is to improve the Article XXIV enforcement through the WTO dispute settlement mechanism.

ACKNOWLEDGMENT

I would like to thank Prof Dr. Thomas Cottier for suggesting this interesting topic of my thesis as well as Prof Dr. Roberto Rios for his supervision and useful guidance. Similarly, I wish to thank Prof. Edwini Kessie and Dr. Erik Eftimov for valuable comments on my work.

INTRODUCTION

This thesis has been divided into three main chapters. Chapter one entitled “The WTO Provisions on Regional Trade Agreements” will be looking at the WTO provisions on Regional Trade Agreements (RTAs). Similarly it has taken up the systemic issues with Article XXIV of GATT and V and Vbis of GATS as identified within numerous GATT Working Parties and its successor the CRTA. It will discuss issues relating the legal consistency of RTAs with the relevant WTO provisions. Similarly, it will look at question on who has to assess the consistency.

Chapter 2 titled “The Treaty Law Framework for RTAs” will be dealing with the possible clarification and interpretative solutions that could be offered for Article XXIV within the ambit of the VCLT. Moreover, the chapter will attempt to clarify the relationship between Article XXIV provisions and RTAs which can be labeled as *inter se* agreements in the general framework of international public law.

Last but not the least, Chapter 3 titled “The Economic Implications of GATT Article XXIV” will deal with the economic implications of the Article XXIV provisions and the economic rationale behind the provision. It will provide the strength and weakness of the economic theory developed along the history in relation to RTAs.

In conclusion, the thesis will provide a few recommendations as to the strengthening of the Article XXIV provisions as well as to its effective implementation.

1. THE WTO PROVISIONS ON REGIONAL TRADE AGREEMENTS

“If the General Agreement on Tariffs and Trade is to retain a significant influence in world trade policy, a new understanding of the meaning and application of Article XXIV is one of the issues that must be resolved. That Article, permitting the formation of customs unions and free-trade areas, is probably the most abused in the whole agreement and the heaviest cross the GATT has had to bear” Haight (1947 cited McMillan 1972, p. 395)

The cornerstone of the WTO Agreement is non-discrimination, a principle which finds expression, *inter alia*, in Article I of the GATT 1994, which obliges WTO Members to grant unconditionally to each other any benefit, favor, privilege or immunity affecting customs duties, charges, rules and procedures that they give to products originating in or destined for any other country. On the face of this rule, a Member of the WTO would be in breach of its WTO obligations if it grants preferential treatment to products originating only in a selected group of countries.

Nevertheless, the WTO, as did previously the GATT, allows its Members to enter into RTAs, albeit under the rules spelled out in:

- Article XXIV of the GATT 1994 (paragraphs 4-10), complemented by the *Understanding on the Interpretation of Article XXIV of the GATT 1994* (the "Understanding"), for customs unions and free-trade areas covering trade in goods;
- the 1979 GATT Decision on *Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries* (the "Enabling Clause", paragraphs 2 (c), 3 and 4), which deals with preferences in trade in goods granted between developing countries; and
- Article V of the General Agreement on Trade in Services (GATS), governing economic integration agreements liberalizing trade in services (for both developed and developing countries). Contrary to the goods area, the special and differential

treatment provided for developing countries is contained in the body of Article V itself.

Other non-generalized preferential schemes require Members to seek a waiver from WTO rules.¹

- Case law which consists of three GATT cases (three panels requested) whereby only two reports were issued but remained un-adopted. The first report from this experience is the *EC-Tariff Treatment on Imports of Citrus Products from Certain Countries in the Mediterranean Region* (hereinafter the EC-Citrus panel report)² and *EEC-Import Regime of Bananas* (hereinafter the EEC-Bananas panel report)³. The WTO era has been marked in this respect by the *Turkey-Restrictions on Imports of Textile and Clothing Products* (hereinafter the Turkey Textile case)⁴. In addition to the later case, there have been three other WTO disputes that have cited the regional trade articles GATT XXIV and GATS V, affirming jurisdiction to examine the compatibility of measures with these provisions (*i.e.* US-Steel Safeguards WT/DS248, US-Lamb WT/DS177 and US-Wheat Gluten WT/DS166).

1.1 Systemic issues in relation to Article XXIV of GATT 1994

As Article XXIV is the cornerstone rule under GATT regulating the regional integration agreements, the analyses will primarily focus on its main provisions and will point out to the infamous ambiguities that can be found therewith.

In the context of GATT Article XXIV analyses, Dam (1970, p. 276) pointed out that:

Article XXIV appears on first impression to set forth a precise set of rules for determining the circumstances under which regional arrangements will be permitted. The apparent precision, as in other detailed passages of the General Agreement, is quite illusory.

¹ For example, non-reciprocal preferential agreements involving developing and developed countries. The GSP scheme is covered by paragraph 1(a) of the Enabling Clause.

² GATT (1985), L/5776.

³ GATT (1994), DS38/R.

⁴ WTO (1999), WT/DS34/R.

The lack of precision resides not only with the substantive rules but also with its procedural aspects.

- ***On the procedural side*** in an effort to streamline the examination process, the General Council of the WTO replaced the previous system of separate working parties with the establishment of the Committee on Regional Trade Agreements (CRTA) in February 1996⁵ which is taking decisions by consensus. Thus, the CRTA as it stands, analyses the regional agreements referred to it by the Council for the Trade in Goods (CTG) for the agreements under Article XXIV of the GATT 1994, the Council for Trade in Services (CTS) for the agreements under Article V of GATS and the Committee on Trade and Development (CTD) for agreements between developing countries, established under the Enabling Clause (WTO document WT/L/127 of 7 February 1979). CRTA also makes recommendations on the reporting requirements for each type of agreement and develops procedures to facilitate and improve the examination process. While this implies a judicial action by way of taking a decision, the CRTA process is not a judicial one, but is suggested to be rather political in nature (Roessler 2000, p.9). However, it is not so clear as to how bound the CRTA is in exercising its authority in this more consensual process, particularly, whether its “decisions” or recommendations are also subject to “appeal” in the DSU. This is only to suggest that the DSU legal developments may not be comparable to the situation of “lower” court that is clearly bound to apply its higher court rulings for new cases arriving on point (Mathis 2002, p. 229).

- ***The substantive issues*** relating to Article XXIV provisions are more controversial and hence, require a more detailed analysis. Although there was an attempt to clarify the rules through the WTO Understanding on the Interpretation of Article XXIV of the

⁵ WTO (1996), WT/L/127.

GATT 1994, adopted as part of the Final Act of the Uruguay Round, it has failed to resolve some of the more difficult issues.

Hence, it was hoped that further clarification would come from the CRTA which also has in its mandate and responsibility “to consider the systemic implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them, and make appropriate recommendations to the General Council”.⁶

Thus, after analyzing the activity of the CRTA in light of its above mandate, Crawford and Laird (2000, p. 9) concluded that in practice, the CRTA has not been able to resolve many of the “systemic” issues, and it is too early yet to say what might be the outcome of a proposal to clarify these issues in the context of new multilateral negotiations.

However, there have been attempts on the part of the CRTA to add clarity on the systemic issues. Consequently, issues arising from the interpretation and application of GATT Article XXIV and GATS Article V have been identified and compiled in a WTO “synoptic paper on systemic issues” (Crawford and Laird 2000, p.10).

As a result, the historical ambiguities with Article XXIV of GATT can be categorized in the following issues as identified by the CRTA:

(i) the “substantially all the trade” issue (Article XXIV:8(a) (i))

- the scope of the requirement

On the scope of the SAT requirement there not been many responses. In this context, Jackson has suggested that the term “substantially” was not accidental but reflected the result of careful consideration in the negotiation and drafting of the text (Jackson 1969, p.20). Similarly, Dam (1970, p. 280) has referred to the substantially all

⁶ WTO (1996), WT/L/127.

trade (SAT) requirement suggesting that “it must refer to something less than “all the trade”, but certainly something more than “some of the trade”. Hence, none of the authors offered an opinion as to whether the requirement is to be imposed upon only duties or only measures, or both. Thus, Mathis (2002, p. 66) had further found in his analyses of the issue that:

The most restrictive interpretation that can be offered would state that duties are to be eliminated on all of the trade. Then, other restrictive regulation as measures would be entertained according to the Article XXIV (8) (b) listing of excepted Articles and as applied according to those provisions. In this reading the SAT requirement grants flexibility for the listed restrictive regulation but does not permit the continuing application or re-imposition of any duties after the interim period.

A less restrictive interpretation suggests that both duties and other restrictive regulations would be covered by the SAT requirement in Article XXIV.⁷ However, Mathis (2002, p.66) concluded that “although more rigorous, the stricter reading is easier to apply and confers a higher degree of legal certainty regarding the nature of the obligation to be imposed upon regional members”

- extent of coverage of the requirement

There exists neither an agreed definition of the percentage of trade to be covered by a WTO-consistent agreement nor common criteria against which the exclusion of a particular sector from the agreement could be assessed. The outcome of in-depth discussions of this issue during the Uruguay Round was a reference, in the Preamble of the Understanding, to the fact that the contribution of regional trade agreements to the expansion of world trade is "increased if the elimination between the constituent territories of duties and other restrictive regulations of commerce extends to all trade, and diminished if any major sector of trade is excluded". However, such a reference in the Preamble of the Understanding did not in fact solve the debate on this subject.

⁷ This could appear to coincide more closely with the punctuation of the text, which provides that, “duties and other restrictive regulations...are eliminated.” However, the issue of the exact coverage to satisfy the SAT requirement (Mathis 2001, p.66).

Hence, the discussion has centered on two possible interpretations which are not mutually exclusive.

The first, a *quantitative* approach, favors the definition of a statistical benchmark, such as a certain percentage of trade between the parties. In the context of Working Group examination, EEC has stated that without a clear definition being provided on quantitative approach, the EEC was prepared to consider (unilaterally) that a free-trade area covering 80 per cent of the trade between the parties will be considered as a qualified agreement. This was for the first time when the so called 80 per cent requirement was referred to by the GATT Working Party. However, although it has been occasionally applied in commentary, it should be noted that the Working Party did not make a finding that this percentage level met the requirement (Mathis 2002, p.67). The second, a *qualitative* approach, would require that no sector (or at least no major sector) be excluded from intra-RTA trade liberalization. In this context, third countries have questioned whether agreements that explicitly excluded trade in unprocessed agricultural products-the case of most agreements-met the substantially-all-trade requirement.⁸ A number of participants in existing RTAs argue that account should be taken of whether an RTA facilitates trade in a sector even where trade barriers are not fully eliminated; others consider that trade not covered by elimination of duties and other restrictive regulations of commerce remains subject to the MFN principle, and that partial duty reduction is not permitted under Article XXIV (Crawford and Laird 2000, p.11).

⁸ For example, the working party which examined Sweden's free trade agreements with the Baltic States would have agreed on the full conformity of these agreements with Article XXIV, the rest of whose contents and provisions received broad acceptance, had some members of the working party not claimed that the exclusion from the agreements proper (and separate treatment) of agricultural trade prevented full conformity of the Agreements with the obligations of Article XXIV (Bhala 2001, p. 625).

(ii) “the general incidence of duties and other regulations of commerce shall not the whole be higher or more restrictive” in the case of the customs union
(Article XXIV:5 (a))

This issue has been largely clarified with the 1994 Understanding which specifies that the evaluation of the general incidence of the duties and other regulations of commerce applicable before and after the formation of the customs union shall be based upon an overall assessment of weighted average tariff rates (The Understanding says the weighted average tariff rates and customs duties collected, but the duties cannot be known in advance and notifications are required prior to the formation of the customs union, so the reference to customs duties collected is effectively redundant). For the purpose of this calculation, the applied rates not the bound rates are to be used. The WTO Secretariat, not the parties to the customs union, is to make the calculations according to the methodology used in the Uruguay Round. However, one issue, not mentioned in the WTO checklists is how to reconcile the import-weighted average of duties with the Uruguay Round methodology of computing arithmetic average for commitments in the agricultural sector. The principal decision to be made in this context is whether the words “on the whole” and “general incidence” refer to each item in the common external tariff schedule or to the common external tariff schedule as a whole. As Dam (1970, p. 277) concluded on this issue:

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

Certainly, the difficulty in interpreting these provisions is recognized in the Understanding where it states that "for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows may be required". Moreover, in relation to ORCs, the AB in Turkey Textile stated that it agreed with the Panel, "that the effects of the resulting trade measures and policies of the new regional agreement shall not be more trade restrictive, overall, than were the constituent countries' previous policies." Further and as also determined by the Panel, the assessment on this point requires an "economic" test for determining whether a specific customs union is compatible with Article XXIV"⁹.

(iii) "Other regulations of commerce"(ORCs) and "other restrictive regulations of commerce" (ORRCs)

The issue in this context is whether the two terms are synonymous and what are those regulatory and internal measures that could be covered by the two terms. Also, another question in this context is whether the rules of origin will be captured by the first of the second term. The clarification of this question is important as "the liberalization across a whole range of so-called regulatory activities would necessarily have the effect of reducing internal barriers at the expense to external trade (Mathis 2002, p. 244).

- other regulations of commerce (ORCs), Articles XXIV:5 (a) and XXIV:8 (a) (ii)

The debate on this term runs up against the issue of definition and measurement of non-tariff barriers. "Regulations of commerce" is an expression which has been used

⁹ WTO (1999), WT/DS34/AB/R.

in the GATT legal texts only in connection with RTAs. No definition of the term is provided.¹⁰ Yet, among the relevant measures which have been identified by some WTO Members are anti-dumping duties, preferential rules of origin, technical standards, subsidies and countervailing measures, whose "scope and importance of those measures has increased in the post-Uruguay Round period" (WT/REG/M/4, para.60). Similarly, the Turkey Panel offered a definition for ORCs, which was not overruled by the AB. Thus, the Panel stated:

"More broadly, the ordinary meaning of the terms 'other regulations of commerce' could be understood to include any regulation having an impact on trade (such as measures in the fields covered by WTO rules, e.g., sanitary and phytosanitary, customs valuation, anti-dumping, technical barriers to trade; as well as any other trade-related domestic regulation, e.g., environmental standards, export credit schemes). Given the dynamic nature of regional trade agreements, we consider that this is an evolving concept".¹¹

As to the definition provided by the Panel, Mathis (2002, p.244) suggested that although broad, there is every reason to believe that the above definition of ORCs will be sustained as it concerns the impact of undertaken measures upon non-members which is talked in paragraph 5. However, this definition of ORCs may not be satisfactory in the context of Article XXIV:8 (a)(ii). If the definition would hold in the context of paragraph 8, that would imply that the Members of the customs union will have to harmonize their external policies in respect to "all of the regulatory measures that can possibly affect trade"¹² (Mathis 2002, p. 245). This may be impossible to carry and definitely would put a very heavy burden on the customs unions as such an interpretation would require not only a high degree of economical integration but also political.¹³ Thus, Mathis (2002, p.245) concluded that there are only two options to

¹⁰ WTO (1998), WT/REG/W/17/Rev.1.

¹¹ WTO (1999), WT/DS34/R, para. 9.

¹² This is due to the very broad definition provided by Panel in Turkey Textile case for ORCs.

¹³ It is only EC that can possible satisfy such requirement due to the advanced political and economical integration. The EC has external exclusive competence in regard to technical barriers to trade since the ECJ Opinion of 1/94.

solve the problem: either to confine the definition provided by the Panel to the ORCs of paragraph 5 alone or, to apply the definition only to measures undertaken by regional members that are distinct and discriminatory as to non-members.¹⁴ Moreover, the ORCs as defined by the Panel also cannot possibly be equivalent to ORRCs as contained in paragraph 8 (Mathis 2002, p. 245).

Another problem is raised hereby in relation to the measurement of non-tariff barriers. It is not clear, for example, what methodology should be used to aggregate commitments on domestic supports and export subsidies (Crawford and Laird 2000, p.12).

- other restrictive regulations of commerce (ORRCs) Article XXIV:8(a) (i) and (b)

If the ORCs definition provided by Panel above were to capture the ORRCs as enshrined in Article XXIV:8, it would imply that “any regulatory matter affecting trade between the parties would be subject to elimination as between them”¹⁵ (Mathis 2002, p. 245) and it is doubtful that the drafters intended such an effect of a deeper integration. Thus, one may conclude that the ORCs and ORRCs are not at all synonymous.

The ambiguity of ORRCs has arisen in connection to the issue of quantitative restrictions, as in order for a regional agreement to satisfy the conditions of Article XXIV, “restrictive regulations of commerce” must be eliminated on “substantially all” inter-member trade, except that “where necessary” quantitative restrictions “permitted under Articles XI, XII, XIII, XIV, XV and XX” may be retained.¹⁶ Thus, as Dam (1970, p. 280) put it the ambiguity concerns the right of a member state of a regional grouping to eliminate quantitative restrictions on imports from other member states

¹⁴ Thus, were one regional party accords internal treatment more favorable to another regional partner, for example by an act of recognition, this is also an MFN issue as to the non-member, by operation of Article I.

¹⁶ Article XXIV:8 (a) (i).

while retaining them on imports from nonmember countries. However, according to GATT Article XIII, except as provided in Article XIV, quantitative restrictions must be applied in a nondiscriminatory fashion, hence, the elimination of quantitative restrictions against members only entails discrimination and for this purpose, Article XIV does not qualify Article XXIV as an authorized exception. In this context, Dam (1970, p. 280) concluded that “the argument that Article XIII prohibits the discrimination entailed in eliminating quantitative restrictions against members only is almost certainly wrong”. It can not be doubted that Article XXIV permits the elimination of tariffs against members only¹⁷, hence, one can conclude that it is not the most-favored-nation clause alone that is being waived.

Nonetheless, an important legal objection may be whether a new member of a custom union may apply a quantitative restriction or other measure already being applied by other members, consistent with WTO obligations.¹⁸

The Turkey Textile Panel ruled that Article XXIV does not provide the cover for any violation of WTO obligations, other than the MFN obligation¹⁹. While the constituent members of a customs union are required to adopt substantially the same regulations of commerce, other WTO-compatible alternatives could have been adopted by Turkey in order to fulfill this obligation. This decision was essentially upheld by the WTO Appellate Body, which ruled that Article XXIV *may* justify a measure which is inconsistent with certain other GATT provisions, but *only if* the “measure at issue is

¹⁷ Article XXIV:5 states that “the provisions of this Agreement shall not prevent ...the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or a free-trade area” complying with Article XXIV of GATT 1994.

¹⁸ The point made by Dam (1970, p. 281) in this context is that “quantitative restrictions may be maintained only for balance of payments purposes, and in the situation of application against non-members only, the BOP justification for the quantitative restriction is likely to be of doubtful validity. If the member country in question were in serious balance of payments difficulties, the quantitative restrictions would have to be applied against all foreign currencies, including the of the other member countries. The only other solution consistent with a legitimate balance of payments justification would be the adoption of common external quantitative restriction by the regional grouping as a whole”. But, as Dam (1970, p. 281) recognized, such a solution “would create further legal questions for which General Agreement has no unambiguous answer.”

¹⁹ Contrary to what Dam (1979, p. 280) has found.

introduced upon the formation of a customs union that fully meets the requirements of sub-paragraphs 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of that customs union would have been prevented if it were not allowed to introduce the measure at issue."²⁰

(iv) The relationship between paragraph 4 and paragraphs 5 through 9 of Article XXIV

The controversy in this context is related to question whether Article XXIV:4 stating that the purpose of an RTA "should be to facilitate trade" among the parties and "not to raise barriers to the trade" of third parties, is a general statement of principle or an additional condition to be satisfied? To put in other words, if an agreement clearly complies with paragraph 4, is it automatically to be considered as meeting the standards of paragraphs 5 through 9 or, does paragraph 4 really contain only introductory language, and, in view of the word "accordingly", are the substantive rules to be found in paragraphs 5 through 9? (Dam 1970, p.276). This issue has for the first time appeared in the review of the Rome Treaty creating the EEC and has been overlooked since then once the EEC has managed to shift the attention to other issues (Mathis 2002, p. 66).

Looking at this relationship, the Panel in Turkey Textiles has indicated that, the linkage between paragraph 4 and 5 is introduced by the term "accordingly". Thus, paragraph 4 reveals that the purpose of a customs union is to facilitate trade between the constituent members and not to raise new barriers to the trade with third countries. The Appellate Body noted that this was affirmed by the 1994 Understanding on Article XXIV. Furthermore, the AB found that:

Paragraph 4 contains purposive, and not operative, language. It does not set forth a separate obligation itself but, rather, sets forth the overriding and

²⁰ WTO (1999), WT/DS34/AB/R.

pervasive purpose for Article XXIV which is manifested in operative language in the specific obligations that are found elsewhere in Article XXIV.²¹

Thus,

...the chapeau of paragraph 5, and the conditions set forth therein for establishing the availability of a defense under Article XXIV, must be interpreted in the light of the purpose of customs unions set forth in paragraph 4. The chapeau cannot be interpreted correctly without constant reference to this purpose.²²

Hence, a clearcut conclusion can be made that paragraph 4 is neither an independent obligation nor a separate legal requirement to apply Article XXIV exception.

(v) Exhaustive vs. non-exhaustive listing in Article XXIV:8 (b)

How are certain internal differences in the WTO regulatory framework to be reconciled? For example, safeguards are normally to be applied on an MFN basis. Given that the list of exceptions cited in Article XXIV:8²³ does not include safeguards or anti-dumping measures, the question arises of whether this list is *exhaustive* or *illustrative*. In this context, Mathis (2002, p. 60) identified the exceptions contemplated by these listed Articles as including:

- (i) export restrictions to prevent shortages of foodstuffs or other essential products;
- (ii) restrictions connected with the classification, grading and marking of commodities;
- (iii) restrictions necessary to safeguard the country's external financial position in balance of payments and related exchange control restrictions; and
- (iv) the general exceptions to protect human, animal or plant life or health, etc

Those favoring the former interpretation, *i.e.* that the list is exhaustive, argue that RTA parties should not apply safeguards against each other, while those favoring the

²¹ WTO (1999), WT/DS34/R, para 57.

²² *Ibid*, para 58.

²³ "...duties and other restrictive regulations of commerce (except where necessary, those permitted under Article XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between constituent territories in products originating in such territories" Article XXIV:8(b).

latter interpretation argue that safeguard measures should be applied on an MFN basis (Crawford and Laird 2000, p. 13). In practice, members of certain free trade agreements have sometimes exempted regional trade partners from safeguard actions. However, third countries have often taken issue with an interpretation of Article XXIV that permits a departure from all GATT obligations requiring non-discriminatory treatment (Bhala 2001, p. 626).

In the context of this discussion, the EEC expressed the view that Article XXIV:8(b) requirements could not have been intended to be exhaustive in enumerating the only restrictions that could be permitted between members of a free-trade area. This was demonstrated *a contrario* by the fact that Article XXI, GATT's basic exception for national security measures, was also not listed under Article XXIV (8) (b) (Mathis 2002, p. 61). Thus, given the omission of this important GATT exception from the listing,

“It would be difficult ...to dispute the right of contracting parties to avail them of that provision...and it must therefore be concluded that the list was not exhaustive”²⁴

Here, the Turkey Appellate Body only noted that the terms of the sub-paragraph provide,

“...that members of a customs union may maintain, where necessary, in their internal trade, certain restrictive regulations of commerce that are otherwise permitted under Article XI through XV and under Article XX of the GATT 1994”²⁵

Clearly, the above does not say that parties may only maintain only the listed measures. In addition, according to the EEC position, any restrictions that regional parties decided to impose upon their mutual trade that did not cumulatively detract

²⁴ WT/REG/M/15, para 18.

²⁵ WTO (1999), WT/DS34/AB/R, para 48.

from the substantially -all trade requirement should be permitted in any case²⁶ (Mathis 2002, p.61).

On the contrary, the findings by the Argentina Appellate Body,²⁷ which is relevant in our analyses, suggest in this context that a customs union (or one of its members) violates Article 2.2 of the WTO Agreement on Safeguards any time a safeguard is imposed that excludes another member from the application. This follows from the Appellate Body recognition that Article 2.2 of the Agreement is unequivocal (and pre-eminent) in requiring that safeguard measures shall be applied to a product imported irrespective of its source.

Thus, from the above finding of the Appellate Body, one may conclude that in order for the member to secure its GATT compatibility when applying the safeguard measure on discriminatory basis, “it seems that it would be necessary for the regional member or the customs union to successfully invoke an Article XXIV defense” (Mathis 2002, p. 237). Hence, for the member to overcome such GATT inconsistency, it will have to comply with the test set by the Appellate Body in the Turkey Textile case, *i.e.* first, the customs union must meet all the requirements of the Article XXIV subparagraph 8 (a) and 5 (a) and second, the formation of the customs union would be prevented if it were not allowed to introduce the measure.

Thus the issue on the exhaustive vs. illustrative listing in Article XXIV:8 (b) could be stated as follows: “Whether it is necessary for a customs union to make a selective investigation and application of its safeguard (so that other members are excluded

²⁶ Thus, as suggested by Mathis (2002, p.61) if the EEC’s understanding of Article XXIV:8 (b) would hold, this would also have significant implications for the future practice, as it would necessarily follow that regional parties would have the flexibility to engage in any practice to restrict the trade of their partners, as long as overall cumulative criteria of meeting substantially-all of the trade was met. Effectively, if the listing of GATT Article restrictions provided in the Article XXIV would be understood to be non-exhaustive, then they also must be considered to be essentially redundant.

²⁷ WTO (1999), WT/DS121/AB/R.

from the measure) in order to meet the requirements as imposed by sub-paragraph 8 (a) (i) or 8 (b) of Article XXIV?" (Mathis 2002, p.236).

- Other issues relating to Article XXIV of GATT 94

Some other significant issues in the context of Article XXIV which have not been in so far considered at great extent refer but are not limited to:

- What is the implication if an FTA member raises MFN rates within bound levels?
- What is the scope and nature of compensation to third parties for any injury caused by the creation of RTAs?
- How does one resolve the problem that notifications under Article XXIV are intended to allow other Members to comment prior to implementation, but in practice are often made on a *post hoc* basis after ratification by national legislatures?
- Is there any substantive difference between interim agreements, which are also agreements *per se*, and agreements with transition periods?

The other issues which have been discussed at a lesser extent by the CRTA refer to the:

- RTAs concluded under the Enabling Clause covering agreements between developing countries. RTAs formed under the Enabling Clause need not cover substantially all the trade; does not require duty elimination; has no fixed time table for implementation; and is not subject to periodic reporting requirements.
- RTAs involving countries at different stages of development (developed, developing or in transition). The developed countries tend to have wider trade coverage and generally apply their commitments over a stricter time-frame than their partners.

Article XXIV does not contain any provision for such asymmetrical application of the WTO rules, although this would seem consistent with the principle of special and differential treatment for developing countries (Crawford and Laird 2000, p.10).

1.2 Systemic issues under GATS Article V and Vbis

As Article V GATS imposes only two conditions upon the Member entering an RTA, it seems to impose a laxer standard than in the case of GATT Article XXIV. Thus, in order for an RTA to be WTO consistent it would have to:

- (1) have a substantial sectoral coverage; and
- (2) abolish discrimination

According to a footnote to the text of GATS Article V, the term “substantial sectoral coverage” is to be understood in terms of number of sectors, volume of trade affected and modes of supply. Moreover, in order to qualify for the substantial sectoral coverage, no “*a priori*” exclusion of any mode of supply should be undertaken. Thus in contrast to the CRTA approach under Article XXIV that no major sector should be excluded to qualify for the substantially all trade requirement, it is clear that under the GATS Members are not required to include sectors that they have not previously liberalize on an MFN-basis.²⁸ (Mavroidis ca.1999, p. 25).

Taking into account that, the requirements in GATS Article V are less stringent than those appearing in Article XXIV GATT, it is expected that the requirements with the former will create less controversy as compared to the earlier. Nevertheless, the CRTA paper on systemic issues related to RTAs²⁹ reveal a few systemic issues relating to Economic Integration Areas (EIA) under the GATS. Thus, there have been different views on the extent to which liberalization must take place within the

²⁸ However had such a requirement been introduced regionalism in GATS could prove to be a vehicle for liberalization that would have been in line with the Bhagwati’s open regionalism aspiration (Mavroidis ca. 1999, p. 25).

²⁹ WTO (2000), WT/REG/W/37.

parameters prescribed by GATS Article V:1(a) in order for an EIA to meet the “substantial sectoral coverage” test.

- the scope of the “substantial sector coverage” criterion

WTO members have different views as the coverage of the “substantial sector coverage” criterion, in particular on whether one or more sectors can be excluded from an EIA. Thus, some argue that the “number of sectors” as set out in the footnote to Article V:1 (a) is an indication that not all the sectors must be covered. In contrast to this approach, some other members believe that the flexibility provided by the word “substantial” does not allow for the exclusion of a sector from EIA.³⁰ Japan and Korea have farther elaborated on the debate maintaining that “essential” services (such as transportation for example) may not be excluded from coverage by an EIA.³¹

- the coverage of modes of supply

Although, it seems clear from the wording of the footnote to Article V:1(a) that no modes of supply should be a priori excluded, some members however have exempted from certain Mode 4 aspects through Annex on the Movement of Natural Persons. However, these aspects had to be included in the EIA for the agreement to be consistent with the GATS.³²

- degree of detail of the examination

The issues raised in this context are whether the examination of the substantial sectoral coverage should be made on sector-by-sector basis, sub-sector-by-sub-sector basis or on a completely disaggregated basis. Thus, as can be seen the CRTA Synopsis these are the following: (i) how can it be determined whether all sectors have been covered or not; (ii) how is the volume of trade affected to be calculated where a sector is less than fully liberalized and would it make sense to include in the

³⁰ Ibid.

³¹ WTO (1999) WT/REG/M/22, para 16 cited in WTO (2000), WT/REG/W/37.

³² WTO (1999), WT/REG/M/22, para 16.

calculation only that portion of trade in a sector that has been liberalized by the provisions of EIA; (iii) how would the “absence of elimination of substantially all discrimination” and the list of excepted measures under Article V:1 (b) affect the percentage targets that might be set.

-unavailability of reliable data on trade in services

In relation to this point, the CRTA recognized the scarcity of reliable data on statistics on the volume of services traded and therefore it was suggested that data on domestic economic activities could be used instead.³³ Thus, it has been further suggested that statistics on the size of domestic market of services sectors concerned or their contribution to GDP could help determine the coverage of sectors, based on the assumption that a sector representing more than a certain proportion of GDP was bound to be significantly traded within a EIA³⁴

-scope of the list of exceptions

The debate in this context is very similar to the one in the context of RTAs under GATT Article XXIV:8. Thus, several members have expressed the view that the list is not exhaustive³⁵ arguing that the expansion of the list of exception has been considered permissible on the basis of the Preamble of the GATS, which refers to “the rights of Members to regulate, and introduce new regulation, on the supply of services within their territories in order to meet national policy objectives”; however, Japan has expressed the view that what is covered in the national treatment clause should not be added to the list.

- other issues identified in the context of GATS Article V

The other issues identified by the CRTA are but not limited to the following:

³³ Ibid, para 8.

³⁴ Ibid, para.20.

³⁵ Ibid, paras. 16, 18 and 20.

(i) What types of discriminatory measures, besides those that fall under the enumerated Articles of the GATS, should be considered as legitimate exceptions from the requirement in Article V:1 (b) for the “absence or elimination of substantially all discrimination”?³⁶

(ii) How should the requirements of Article V:1 (b) be interpreted in view of further negotiations contemplated under Articles VII, X, XIII, XV, and the various annexes to the GATS?³⁷

(iii) Do all existing EIAs meet the test of Article V:1 (b) that all forms of discrimination with respect to the regulation of professional services, air transportation services and financial services are eliminated? Do they all provide for the elimination of all forms of discrimination in government procurement of services or in the provision of subsidies to services suppliers?³⁸

1.3 The consistency assessment of RTAs with relevant WTO provisions

The legal consistency of the RTAs/EIA with GATT Article XXIV/GATS Article V is currently examined within the CRTA under the WTO which will take such decision on consensus basis. In this context, it should be mentioned that the change from the Working Parties to the institution of CRTA did not result in any positive change in respect to the examination of RTAs consistency. In other words, the consensus rule which is considered the source of all misfortunes with the Working Parties activity did not change, hence, has been taken over by CRTA.

However, a positive change has been introduced in the RTAs consistency examination upon the approval of the Understanding that contains an explicit directive to all concerned that Article XXIV GATT-related claims are justiciable. Such

³⁶ HCK, non-paper entitled Systemic Issues arising from Article V of the GATS, para.2.

³⁷ WTO (1999), WT/REG/W/34, para.9

³⁸ Ibid, para.9

a development however does not excuse the question of whether WTO Panels/AB can look at the consistency of a particular RTA with the GATT Article XXIV. In this context, the Panel in the EC-Citrus case holds that for the proposition that GATT panels can examine individual measures but not the overall consistency of the PTA with the multilateral rules.³⁹ However, the report was un-adopted and hence, of limited legal relevance. The Turkey Textile case is definitely of more guidance in this respect as both the Panel and the Appellate Body has referred to this question. Thus, the Turkey Textile Panel report records the view that WTO adjudicating bodies are competent to examine PTA-related issues but should stop short from providing an overall assessment of a RTA consistency with the WTO contract (Mavroidis ca. 1999, p. 33). In the Panel's view, for reasons having to do more with the administrative burden, the CRTA is the more appropriate forum to review consistency of notified RTAs. However, in contrast to the panels finding, the Appellate Body in the same case hold that WTO adjudicating bodies must request from parties raising the RTA-defense to first establish that they have fulfilled the conditions to raise such defense. However, it remains to be seen how much inspiration the future experience will draw from the latter finding of the Appellate Body (Mavroidis ca.1999, p. 34).

³⁹ The relevant passage of the report reads as follows: "The Panel noted that at the time of the examination of the agreements entered into by the European Community with certain Mediterranean countries, there was no consensus among contracting parties as to the conformity of the agreement with Article XXIV.5...The agreements had not been disapproved, nor had they been approved. The Panel found therefore that the question of conformity of the agreements with the requirements of Article XXIV and their legal status remained open".

2. THE TREATY LAW FRAMEWORK FOR RTAs

Since WTO has entered into force and explicitly established as a treaty the customary international law should equally apply to the WTO Agreement in the same manner it applies to other international treaties. Similarly, Article 3 of the Dispute Settlement Understanding expressly provides that the WTO agreements are to be interpreted and applied “in accordance with the customary rules of interpretation of public international law”. It is reminded here that constant case law in the WTO (both at the panel and at the Appellate Body level) hold for the proposition that when Article 3 of the DSU refers to customary rule of interpretation, it refers to the rule of interpretation embodies in the Vienna Convention on the Law of Treaties (VCLT).⁴⁰ It appears that the form of the words (“the customary rules of interpretation of public international law”) was used to confirm the place of the rules reflected in the VCLT in WTO jurisprudence, while recognizing that some WTO members would not be parties to the convention itself (Kuyper 1994, p. 232). Although the wording of this phrase in Article 3 of DSU⁴¹ accommodates states that are not party to the Vienna Convention on the Law of Treaties, the Appellate Body nevertheless, has taken Article 31 of the Vienna Convention as reflective of customary international law (McRae 2000, p.35). Thus, according to VCLT, the WTO Agreements would have to be interpreted in good faith in accordance with the ordinary meaning of the terms in their context and in the light of the object and purpose of the treaty.

Another question arising in this context is whether only the interpretation rules provided for in the VCLT which have been granted to status of customary

⁴⁰ The International Court of Justice had similarly treated the Vienna Convention interpretational rules as reflective of customary international law. See for example the ICJ *Judgment Concerning Kasikili/Sedudu Island (Botswana/Namibia)* from 13 December 1999, available at <http://www.icj-cij.org> visited on 16 July 2003.

⁴¹ “ ... The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law...”

international law, would be applicable in the WTO context or other rules embodied therein can be equally applied to clarify the WTO Agreements. In this context, McRae (2000, p.37) found that:

Although, it might have been thought that the reference in the DSU to the “customary rules of interpretation of public international law” was a reference only to principles of international law relating to interpretation, in fact, the Appellate Body has treated the statement in Article 3 as applying to principles of international law generally. The practice of the Appellate Body suggests that the WTO agreements are interpreted and applied in the light of the “relevant rules of international law”.

Such a distinction between the customary international rules (Article 30 and 31 VCLT) and other rules of general international law in the Vienna Convention is probably necessary in order to identify their applicability to different states. In other words, the customary international law rules such as the rules on interpretation within the Vienna Convention can be invoked vis-à-vis non-signatories of the treaty, whereas this would not be the case with the rules that have not been conferred this status, *i.e.* of customary international rule.

Similarly, in the above context, Pauwelyn (2001, p.539-541) observed that the absence of an explicit contracting out of certain rules of international law in the WTO treaty (as does the WTO dispute settlement mechanism vis-à-vis certain rules of general international law on state responsibility) does not mean that one has contracted out of all of them, nor that WTO rules were created completely outside the system on international law.⁴²

Based on the above one can conclude that not only the interpretation principles of international public law can be used to clarify the WTO agreement but also any other international law norm that would help in to shed light on WTO contentious issues.

⁴² This point is made as a counter argument to those authors and WTO negotiators which have fallen into the trap of taking the explicit confirmation of some preexisting rules of international law in the WTO treaty (such as DSU Art 3.2 confirming customary international law rules on interpretation) as proof that the treaty has contracted out of all other rules of international law (pursuant to the adage expression *unius est exclusio alterius*) (Pauwelyn 2001, p. 541).

This also implies that recourse to general principles of international law can be made to clarify the contentious terms cast by Article XXIV as well as to shed light on the relationship between the WTO Agreement and the RTAs concluded by a subset of WTO Members.

2.1 The application of VCLT interpretation rules to GATT -94 Article XXIV

As discussed above, some authors have attributed a restricted sense to the relationship between the customary international law and the WTO as limiting only to the customary international interpretation rules. Thus, it would be interesting to see to what extent have the interpretation principles available in the VCLT have contributed to the clarification of the systematic issues within the Article XXIV of GATT 1994. For example, how the availability of these interpretation principles in the WTO context have contributed to the clarification of the “substantially all trade” requirement as contained in Article XXIV:8(i) (a). As Mavroidis (ca.1999, p.16) put it, the term is not self-interpreting; to the contrary it invites interpretation. However, left to the discretion of the Member within the meetings of the Working Parties (currently CRTA) there was not much precision added to the term.

Thus, it should be reminded that the interpretative rule contained in Article 31 of the VCLT confines the interpretation techniques to:

- (i) the ordinary meaning of the terms;
- (ii) to be interpreted in their context;
- (iii) in light of their object and purpose;
- (iv) taking into account any subsequent decision;
- (v) taking into account subsequent practice.

According to VCLT Article 31, where the interpreter finds that after carrying the interpreted terms through all the above techniques the meaning of the term is manifestly unreasonable, recourse should be made to supplementary means of interpretation, which are composed from the preparatory work (*travaux préparatoires*) of the multilateral treaty (GATT 1947 in our case). VCLT Article 32 can however be resorted to even after a satisfactory examination of the term under Article 31, in cases where the interpreter wants to secure the correctness of the interpretation work.⁴³ Due to the Panel's reticence to make recourse to the VCLT Article 32 by the Panels, generally it would be used only in the situation when conclusion was reached that the interpretation of the term was manifestly unreasonable.

Thus, it is worthwhile to examine the WTO jurisprudence on each element of Vienna Convention rules, while recognizing that these elements do not represent a number of tests that must be ticked or crossed robotically in a particular sequence - they represent rather a disciplined and holistic approach to determining the relevance and weight of materials in interpreting a treaty provision, in whatever form the materials are actually considered. Sinclair for example seems to favor first amassing all the necessary materials to put the interpreter in the position to assess the relative weight and value of those materials, before actually examining the material in light of the Vienna Convention rules (Lennard 2002, pp.24-25).

(i) The ordinary meaning of the terms

As can be read in Article XXIV:8 (a) (i) the term "substantially all trade" is qualified by the word "substantially". Thus, the term "substantially" unambiguously indicates that not all trade between members of the CU or FTA has to be covered in order to find

⁴³ Such practice is disapproved by the International Court of Justice: it has not accepted arguments based on the preparatory work if one of the parties to the dispute, which is a member of the international agreement at hand, did not participate in the preparatory work. It should be noted that GATT/WTO panels, in general, show the same reticence as the ICJ to have recourse to the interpretation means as laid down in Article 31 VCLT.

their creation compatible with Article XXIV:8 of the GATT. However, the question on how much trade should be covered by term in order for the CU and FTA to pass the test is not clear. During various Working Parties it has been suggested that the term has a qualitative and a quantitative dimension,⁴⁴ in the sense that it covers a percentage of trade and at the same time no major sector of a national economy can be excluded. This interpretation seems to be further supported by one work in the body of Article XXIV:8 that often escapes the attention in discussion of the issue: which is the term “all”. As can be observed, the term is not “substantially most of the trade” or “a substantial portion of the overall trade”; but it is “substantially all trade”. This suggest that the tendency should be to measure everything by reference to 100 percent of the trade involved and check how close on is to this absolute amount. The term used supports if anything a quantitative test to measure what substantially all trade can mean.

(ii) The context

The context of an article within an international treaty is at least the remaining articles of the same agreement and, sometimes, other agreements made in connection with the same or even comparable subject matter. The interpretation of the substantially all trade required is not facilitated by the relevant paragraphs of Article XXIV (4, 5, 6 and 7) and therefore for examining the context, we must turn to other WTO provisions. Thus, one should start by looking at GATT Article I (MFN clause) which requires the WTO Members not to discriminate between products of other WTO Members. This assertion is found, *inter alia*, in the second sentence of Article XXIV:4 of GATT.⁴⁵ Thus, the wording of the sentence recognizes the possibility of upsetting

⁴⁴ See the discussion in Chapter 2.

⁴⁵ “...The also recognize that the purpose of customs union or a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties which such territories.”

the MFN obligation as envisaged in Article I of GATT, *i.e.* not to discriminate. This discrimination is contained in Article XXIV:8 which, on the one hand allows Members of RTA to treat each other more favorable than the outsiders and on the other hand, requires the elimination of duties and other restrictive regulations of commerce with respect to substantially all trade between the member of the RTA. Article XXIV:8 is an exception to Art I GATT only to the extent that Article XXIV.8 GATT has been complied with therefore, such acknowledgment has once consequence: the burden of proof to demonstrate compatibility rests with the party invoking the exception.⁴⁶

(iii) The object and purpose of the agreement

The object and purpose of the WTO is to liberalize international trade on non-discriminatory basis. Consequently, any deviation from this rule must be well justified and should be kept to the minimum possible so as not to undermine the basic purpose and object of the GATT. The complementarity between non-discrimination and regional trade is institutionally acknowledged in Art XXIV GATT: pursuance of one goal does not necessarily make the other redundant. If this were the case, then the interpreter would have a hard time to achieve an effective treaty interpretation in accordance with the VCLT. As a result, the object and purpose of the agreement do not offer any further guidance as to the exact meaning of the term (Mavroidis *ca.* 1999, p.19).

(iv) Subsequent decisions

By this term we understand any formal amendment or interpretative note concluded between the WTO Members regarding the interpretation of the term. No such

⁴⁶ This was also confirmed by the Panel and subsequently by the Appellate Body in Turkey Textile case whereby Turkey had the burden of proof.

decision exists as throughout GATT/WTO the Contracting Parties/Members never adopted an interpretation of the term in this direction.⁴⁷

(v) Subsequent Practice

By subsequent practice we understand the Working Parties' report that has examined throughout the years the compatibility of notified RTAs with Article XXIV (Mavroidis ca.1999, p. 19).

The subsequent practice have been granted an elevated status over other VCLT techniques by the International Law Commission and such practice has often been regarded as "affording the best and most reliable evidence, derived from how the treaty has been interpreted in practice, as to what its correct interpretation is"

(Fitzmaurice 1957 cited Lennard 2002, p.32). It has been long recognized that consistent practice can be close to conclusive in interpreting a treaty provision (Report of the Commission of the General Assembly 1964 cited Lennard 2002, p. 32).

The role of the subsequent practice in interpreting WTO law has been taken up by a few WTO Panels. Thus, in the Turkey Textile case the Panel recalled the statement of the Appellate Body in *Japan – Alcoholic Beverages* whereby it was found that "generally, in international law, the essence of subsequent practice in interpreting a treaty has been recognized as a "concordant, common and consistent" sequence of acts or pronouncements which is sufficient to establish a discernable pattern implying the agreement of the parties regarding its interpretation. An isolated act is generally

⁴⁷ In Turkey Textile case the Panel recalled the statement of the Appellate Body in *Japan – Alcoholic Beverages* whereby it was found that "generally, in international law, the essence of subsequent practice in interpreting a treaty has been recognized as a "concordant, common and consistent" sequence of acts or pronouncements which is sufficient to establish a discernable pattern implying the agreement of the parties regarding its interpretation. An isolated act is generally not sufficient to establish subsequent practice; it is a sequence of acts establishing the agreement of the parties that is relevant."

not sufficient to establish subsequent practice; it is a sequence of acts establishing the agreement of the parties that is relevant⁴⁸. Moreover, the Panel found that:

In light of these positions taken by individual GATT contracting parties before the entry into force of the WTO Agreement and therefore the ATC, we cannot conclude that there is "subsequent practice" (as that term is used in the VCLT) or "customary practices" (as used in Article XVI:1 of the WTO Agreement) that could be regarded as an agreement or acceptance (even implicit) that paragraphs 5(a) or 8(a)(ii) of Article XXIV authorize or require the introduction of otherwise GATT/WTO inconsistent measures upon the formation of a customs union...(WT/DS34/R, para 9.169)

The numerous Working Parties under the GATT as well as the CRTA did not come up with an exact definition for the "substantially all trade" requirement. Nothing changed in this respect in more recent years.⁴⁹ The GATT Analytical Index (vol.2) on p. 824 in footnote 162 provides an exhaustive list of Working Party reports dealing with this issue. However, the outcome is still the same: no clarification has been added to the term.

Quite recently Australia has tabled a proposal on the clarification of the term which is at least worth discussing.⁵⁰ It has proposed that SAT should be defined as coverage by a free-trade agreement or an agreement establishing a customs union of 95 per cent of all the six-digit tariff lines listed in the Harmonized System. It has further accepted that the 95 per cent figure is an arbitrary one but intended to move negotiations out of a deadlock and provide a rule of thumb. Australia was also mindful of the fact that in case trade is concentrated in only few products, the 95 percent figure could exempt sizable trade flows. This is why is also proposed an assessment of prospective trade flows under an arrangement at various stages. If accepted, the proposal would replace the never-ending discussion on the meaning of "substantially all trade" through a rule of thumb (Mavroidis ca.1999, p. 20).

⁴⁸ WTO (1999), WT/DS34/R, para. 9.165

⁴⁹ Working Party report on "EEC-Agreements with Finland", BISD 29S/79, para 12.

⁵⁰ WTO (1997), WT/REG/W/18.

Another interesting question that can be raised in this context is to what extent the existent case law can be used as a subsequent practice in interpreting the WTO terms.

The Appellate Body in *Japan-Alcohol case*⁵¹ rejected the view of the Panel in the same case that: 'Panel reports adopted by the GATT Contracting Parties and the WTO Dispute Settlement Body constitute subsequent practice in a subsequent case, however. While there has been some criticism of this aspect of the Appellate Body Report, the Appellate Body's reasoning is consistent with the fact that adopted reports only in a binding fashion the instant matter between the two parties in the dispute, and accords with WTO's lack of a formal system of binding precedent, even though, in practical terms, prior decisions are not lightly departed from. As McRae (2002, p.35) noted in this context:

Perhaps the key point is that, even if such adopted reports constituted 'subsequent practice', it would also need to be shown that 'they establish the agreement of the parties' *on the point of interpretation*.

Hence, the WTO Appellate Body's cautious approach provided in *Japan-Alcohol case*⁵² to subsequent practice is an appropriate response at this point in WTO jurisprudence.

The above exercise was intended to provide an understanding on how the Vienna Convention rules on interpretation would be used by the Panel/Appellate Body in order to clarify the meaning of contentious terms in the WTO Agreement. However, even after carrying out this exercise, at the end of the day the meaning of substantially all trade requirements remain obscure. For this reason, having exhausted the interpretation techniques prescribed by Article 31 of Vienna Convention, one may turn to supplementary means of interpretation. In this context,

⁵¹ WTO (1996), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R.

⁵² Ibid.

Mavroidis (ca.1999, p.21) has considered the substantially all trade requirement in light of the preparatory work (*travaux preparatoire*) concluding that it is also of not much help. Thus, he found that in a series of papers that the WTO secretariat prepared for the CRTA⁵³ point to the looseness of the term as used by the drafters of the treaty.

However the above does not imply that the interpretation techniques provided for in the Vienna Convention are not sufficient to clarify contentious terms. It is rather the specificity of the substantially all trade requirement that does not allow a clarification using these techniques. In other words, the term indeed requires clarification either in the Article XXIV itself, or alternatively in the CRTA⁵⁴ or within WTO adjudication process.

⁵³ WTO (1997), WT/REG/W/17 and WT/REG/W/17/Add.1.

⁵⁴ Here however it should be noted that there is a high disincentive among Members to clarify the issue, hence, it will not be possible to do so under this body as long as the consensus rule will continue to exist therewith.

2.2 The WTO-RTAs relationship

In so far only the VCLT relevant interpretation rules have been used in the WTO context. Although as early found by McRae it would be permissible to seek clarification of WTO agreements by any means provided in international public law generally, the question on how other non-interpretation VCLT rules provisions apply to the WTO *aquis* is not unambiguous.⁵⁵ It has not been given much importance within WTO and none of the GATT or WTO Panels/Appellate Body had taken up the issue, preference being given rather to particular national measures challenged in each case (Cottier 2004, p.10). Therefore, it would be interesting to examine whether GATT law will continue to govern in the context of regional trade arrangement concluded between two or more WTO Members (also referred to as *inter se* agreements⁵⁶) and whether the GATT - RTA relationship could be clarified within the treaty law framework making use of the relevant international law provisions.

In this context, McRae (2000, p.35) has indicated that VCLT Article 30 would be the reference point for dealing with successive treaties on the same subject matter as, “this provision is clearly relevant as well when looking at prior subsequent international agreements that may be inconsistent with the WTO agreements”. Furthermore, it has been recognized that VCLT brought a great contribution to international public law by “embracing the situations caused by later (successive) treaties” (Degan 2002, p.273).

Thus, in the treaty law, the WTO-RTA relationship can be defined in terms of temporal sequencing which is regulated in the Vienna Convention which has cast the

⁵⁵ Here it should be considered that GATT Article XXIV does not contain any provision to be applied in the instance of conflicts between the WTO rules and those contained in the RTAs, therefore the general international rules on treaty conflict prescribed by the VCLT will apply.

⁵⁶ *Inter se* are “...agreements entered into by some only of the parties to a multilateral treaty and intended to modify it between themselves alone.

issue in Article 30 titled, *Application of successive treaties relating to the same subject matter* and Article 41 titled, *Agreements to modify multilateral treaties between certain of the parties only*.

Article 30 of Vienna Convention establishes its pertinent rule in paragraph 4 and 3, that where the parties to the later treaty do not include all the parties to the earlier one, the early treaty applies, “only to the extent that its provisions are compatible with those of the later treaty”.⁵⁷

It should be noted however that these provisions apply only to the extent that they refer to the same subject matter. This implies that if subsequent treaties are more detailed or are taking up issues not reflected in the first treaty, Article 30 of Vienna Convention would no longer apply. As not all such agreements will coincide in the subject matter, Article 30 is complemented by 41 of Vienna Convention which, as shown above, covers the *inter se* agreements. Thus, Article 41 is referred to in Article 30 itself in paragraph 5, whereby the later establishes conditionality to the general “last in time rule” as envisaged therein⁵⁸.

Article 41 provides two situations which should be used in alternative to allow modifications by a subset of Members to the early treaty. The first option provided in paragraph 1(a) permits the modification of multilateral agreements through subsequent *inter se* agreements if such an option is provided for in the multilateral agreements, in other words if the “contracting out was contemplated in the treaty” (Mathis 2002, p. 275). The second alternative option is stated in paragraph 1(b) governing the modification of multilateral agreements when the earlier treaty does not

⁵⁷ VCLT, Article 30, para 3.

⁵⁸ Especially that VCLT Article 30, para 5 provides that para 4 therein is without prejudice to, “any question of responsibility which may arise for a State from the conclusion or application of a treaty the provisions of which are incompatible with its obligations towards another State under another treaty.” The VCLT Article 41 test is more narrowly prescribed as the drafters were of the opinion that the *inter se* agreements are more likely to run counter the object and purpose of a multilateral treaty than a treaty amendment that required the participation of all parties reflected in VCLT Article 40 (Mathis 2000, p. 274).

prohibit the subsequent modification. In other words, it governs the situations when the multilateral agreements are silent about its modification. In such cases, modifications are allowed only if only if they do not affect the rights and obligations of the other parties and are not contrary to the object and purpose of the multilateral treaties.

Looking into the question of where to fit the RTAs as subsequent modification to WTO treaty,⁵⁹ Mathis (2000, p.277) have concluded that Article 41.1(a) is effective, rather than 1 (b) and that in this case, the terms of the granting treaty would dictate and control the circumstances by which modification may be entertained. When carrying out these analyses, Mathis had further found that although the WTO Agreement does not provide an Article expressly granting the right of two or more parties to enter into a modifying bilateral agreement, however GATT-94 does appear to contain some permissive clauses, including Article XIX on safeguards measures, Article XXV on granting waivers and Article XXIV⁶⁰ itself together with the 1994 Understanding. It should be noted however, that such permission is conditional upon the showing that paragraph 8, 5 and 7 of Article XXIV gave also been fulfilled. The conclusion in this context was that WTO has generated its own scheme for permissive modification, hence, as shown above, it should be recognized that this scheme is highly exigent on its Members.⁶¹

⁵⁹ That is the granting treaty in our case.

⁶⁰ The permissive modification option with GATT Article XXIV can be derived from its para 5 stating that, "...the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area...provided that..."

⁶¹ It appears that this grant of a modification is also limited by the types of suspensions as to GATT articles and considerations of internal trade coverage that are provided by paragraph 8.

While answering in affirmative the question of whether the GATT law continues to control the RTAs, the above analyses, in fact are throwing us back into the WTO realm.⁶²

What can be concluded on this debate is that there is certainly no general right of modification to be accorded to parties of a multilateral agreement, on basis other than those expressly established in the VCLT. From this it follows that in fact, parties to the RTAs would not have a right to modify the GATT provisions unless this is done strictly in conformity with Article XXIV, as only the terms therein control the intended modification. This also implies that:

“...where a GATT Article states that “Members shall”, then regional members are also bound by that obligation. To suspend it they should be able to identify how the action is necessary in order to comply with the requirements of Article XXIV, or should identify some other exceptions, or obtain a waiver as according to the same procedures that govern WTO Members generally” (Mathis 2002, p.281).

Thus, it would be difficult to assert that the modification provisions with the Vienna Convention would support the practice of Members to develop modifications to the GATT-94 other than by means established therein. This leads as to another conclusion, that Members of the RTA can not argue on the legitimacy of their agreement based on the assumptions or facts that the agreement in question does not affect the rights of other parties and that the modification is not incompatible with the object and purpose of the treaty.⁶³

⁶² When it comes to WTO both Article XXIV provisions and relevant case law findings will have to be considered in order to establish whether the RTA conclusion was legitimate. Here particular regard should be given to Turkey Textile case whereby the Appellate Body set the principle test to be carried out in order to decide on the legality of maintaining internally restrictive measures (*i.e.* that the measures was introduced at the formation of the CU and it was necessary for its creation). The analyses of the Vienna Convention provisions on modification (provided that the RTAs are modification in the sense of Art 41.1(a)) does not suggest another conclusion, hence, it gives the above test the same effect when assessing the legality of internally restrictive measures within the RTAs.

⁶³ This argument was put forward by the EC within one of CRTA meetings, EC Statement, WT/REG/M/14, 24 November 1997, para 13. It appears that EC delegate was of the opinion that the RTAs would fall within the ambit of Article 41.1 (b) rather than Article 41.1 (a) of the Vienna Convention.

Another perspective on the WTO-RTA relationship is offered by Pauwelyn (2001, p. 544), who is of the opinion that in answering the question of what agreement should prevail one should examine the applicable conflict rules⁶⁴ which can be found in three different places: the non-WTO treaties, the WTO treaty itself, and the general international law. Here it should be mentioned that although the WTO treaty contains some conflict norms relating to preexisting treaties, they do not refer to their relationship to other rules of international law in order to provide an answer on conflicts. For this reason, Pauwelyn (2001, p.545) has suggested that these rules must be sought in general international law, for example, as reflected in Article 30 of the Vienna Convention.⁶⁵ However, after carrying out the analyses within this provision, Pauwelyn concluded that when it comes to “hard cases”⁶⁶, Article 30 in and of itself hardly offers any solutions. The same conclusion was reached by Sinclair who noted that regarding the interplay between multilateral treaties, Article 30 is “in many respects not entirely satisfactory (Sinclair 1984, p.65). But, both have recognized that Article 41 which is expressly referred to in Article 30(5) offer some solutions. Hence, in his analyses Pauwelyn (2001, p. 548) also points to *inter se* modifications of WTO treaty whereby they have been classified into two categories:

(1) those further liberalizing trade as between some WTO members only, for which the WTO treaty has explicit rules; and (2) those restricting trade in contrast to trade flows called for under the WTO treaty (again as between some WTO members only), on which WTO treaty is silent.⁶⁷

⁶⁴ It has been recognized however that the definition of conflict in international law is unclear. Wilfred Jenks, for example argues that a “conflict in the strict sense of direct incompatibility arises only where a party to the two treaties cannot simultaneously comply with its obligation under both treaties”. Moreover, the WTO Appellate Body in Guatemala-Cement seems to follow this strict definition, defining conflict as “a situation where adherence to the one provision will lead to a violation of the other provision” (WTO (1998) WT/DS60/AB/R, para 65).

⁶⁵ In line with his point expressed above relating to the interaction of WTO law with the rules of international law, Pauwelyn reiterates the application of the conflict rules as long as they have not been contracted out in the WTO law.

⁶⁶ As explained by Pauwelyn, “hard cases” are conflicts between treaty norms for which it is difficult or unreasonable to utilize on point in time as the moment at which they were matched with state consent. The WTO rules also follow this pattern.

⁶⁷ An example of the former is a free trade arrangement and an example of the later is an arrangement between two WTO members not to invoke GATT articles III and XI vis-à-vis certain trade restrictions they both consider

As to the first type of *inter se* modifications, it was found that they are permitted in the WTO treaty itself, in particular in Article XXIV of GATT.⁶⁸ On the other hand, the second type of *inter se* modifications, *i.e.* those restricting trade, are not prohibited in the WTO treaty, meaning that the two conditions prescribed by Article 41.1 (b) will have to be met in order for these agreements to attain legitimacy.⁶⁹ Similar to Mathis, Pauwelyn (2001, p.550) concluded that if (but only if) *inter se* modifications to the WTO treaty meet the conditions set out above, *i.e.* the test in Article 41 of Vienna Convention, they will validly change the legal relationship between the WTO members that are party to modification. However, in contrast to Mathis, Pauwelyn (2001, p. 549) suggested that the *inter se* modifications cannot alter the rights and obligations of third parties,⁷⁰ which is a test contained in VCLT Article 34.

The conclusion one can make in this context is that treaty relations between the WTO members can be modified to the extent that they comply with the provisions of Articles XXIV GATT and Article V and Vbis GATS. As Cottier (2004, p.11) concluded in this relation, the rules of Vienna Convention confirm that the multilateral rules of WTO, notwithstanding Article 30 VCLT, are in result of a higher ranking. Hence, the legitimacy of such modifications will firstly, depend on its compatibility with WTO relevant rules and secondly, on whether the rights or obligations of third WTO members have been modified.

to be justified even they are contrary to GATT rules. The later also could include arrangements between parties not to invoke certain procedural rights granted in the DSU, or on the contrary broadening the scope for “compulsory licensing” of essential drugs in deviation of TRIPS Article 31 (Pauwelyn 2001, p.548).

⁶⁸ The WTO treaty prohibits such modifications unless they (1) extend the increased liberalization to all WTO members in compliance with the MFN treatment or (2) conform to the conditions in GATT Article XXIV (GATS Article V) on regional arrangements (Pauwelyn 2001, p.548).

⁶⁹ The first condition is that the *inter se* agreement may not “affect the enjoyment by the other WTO members that are not parties to thereto of their rights under the [WTO] treaty or the performance of their obligations”; and the second, nor may that agreement relate to a WTO provision “derogation from which is incompatible with the effective execution of the object and purpose of [WTO] treaty as a whole.”

⁷⁰ This is in contrast to Mathis who is of the opinion that the Article 41.1 (a) alone would set the test for RTA legitimacy. This second condition was also emphasized by Thomas Cottier (2004, p. 11).

Another question that has been raised by some authors in this context is: what are the legal effects of entering illegitimate RTAs from the international customary law perspective as compared to the WTO. To put it differently, the question is how the rules and principles of general international law could be read with a view to a better enforcement of WTO law (contracting the proliferation of WTO non-compliant RTAs). In this context one should consider that WTO is *lex specialis*⁷¹ whereby it had explicitly contracted out of certain international law rules on resolution of disputes (for example no counter-claims are allowed under WTO dispute settlement scheme, *i.e.* if the defendant wishes, in turn, to lodge a complaint about the acts of the plaintiff, it must start a new procedure).⁷² However, other international law rules relating to dispute settlement, such as those relating to the burden of proof for example have not been contracting out continuing to apply in the WTO system.

Referring to the conflict of norms in this context, Pauwelyn (2001, p. 550) observed that:

...if customary law rules on countermeasures were to change, the DSU provisions on “suspension of concessions,” which contract out of some of these customary rules and continue to do so given the “continuing” nature of the DSU, would not, in my view, be required to give way to these changes. In contrast, if certain principles on the settlement of disputes not contracts out form by the WTO treaty (say rules on burden of proof) were to change, these would necessary also apply to the WTO.

However, our analyses is centered more to the WTO enforcement mechanism whereby as recognized above, the WTO has come out with its own rules, *i.e.* contracting out of the otherwise applicable international customary law principles. To put it in other words, the enforcement rules of international customary law will not

⁷¹ The principle is encompassed in the international law of treaties whereby more specific treaties or provisions generally take precedence over more general treaties or provisions dealing with the same subject matter. This is the principle of *lex specialis generalia specialibus non derogant*, a principle also widely recognized in domestic statutory interpretation (McRae 2002, p.70).

⁷² Article 3.10 of DSU.

apply to the WTO dispute settlement. From this perspective, under the WTO a Member would request the establishment of a Panel that will examine the complaint in conformity with its terms of reference as prescribed in the DSU. Consequently, if the challenged national measure is found WTO inconsistent, the Panel will make recommendation to bring it in conformity with its WTO obligation. Whenever the measure will be one implemented in the context of a RTA, the non-compliant Member will have to either withdraw the measure or grant most favored nation treatment to all WTO Members. Thus, according to Article 22 DSU, if the Member fails to comply with the above requirements, it will have to face suspension of concessions, but only on perspective basis. In other words, “damages can be obtained neither for past nor for future”. Hence,

the obligations under WTO remain unimpaired and subsequent treaties cannot be invoked to reduce the rights in particular of third Members affected by an agreement inconsistent with the obligations under WTO law. This is in accordance with Article 34 of the Vienna Convention stating that a treaty cannot establish rights and obligations for third states without their consent (Cottier 2004, p. 11).

Coming back into the realm of international customary law it should be noted that violations trigger state responsibility and the obligation to undertake any steps necessary for remedies (Simma 1984, p. 508). Thus, under the customary international law the injured state can claim *restitutio in integrum* whereby the responsible state would have to provide effective remedy in the form of damages for both past and future violations. However, as noted above, this principle is of little guidance in WTO law, because WTO treaty has expressly contracted them out by operating completely new rules on dispute settlement. Hence, it appears that the only solution left is to further clarify and strengthen the WTO-RTA relationship within the

ambit of the WTO treaty itself, especially that the Vienna Convention limits the enforcement and implementation to preserve third party rights (Cottier 2004, p.12).

With the view to establish some hierarchy of norms between the two, some reform option would be to require Members envisaging the conclusion of RTAs to expressly state the priority of WTO law in their regional agreements.⁷³ Another, more preferable solution would be to define the conflict norms within the WTO treaty granting priority to WTO law over RTA, or “what lawyers today may call a constitutional approach of regulating preferential agreements by and through the disciplines of WTO law” Consequently, “the RTAs not conforming to Article XXIV GATT or V GATS would be unlawful and no longer applicable” (Cottier 2004, p. 12). As the two options presented above may be difficult to implement due to the fact that they would require lengthy negotiations and ultimately, the consent of all the WTO members, a third option can be suggested. Thus, the WTO-RTA relationship could be taken up for clarification through the WTO case law. Although it has been argued that this option may face important limitations due to the undefined role of the entire corpus of the Vienna Convention in the WTO law,⁷⁴ it may render after all more effective.

Last but not least, it is one thing to talk about modifying rules in order to seek clarification and another thing is to talk about rule enforcement. In the absence of an effective implementation system under the WTO, the above reform options may result in new fancy rules alone and may not tackle the concern of WTO non-compliant RTAs proliferation.

⁷³ Although, as Roessler (2000) pointed out, due to sometimes rudimentary rules contained in the RTAs as compared to WTO treaty, many RTA are referring to the WTO *aquis* for the cases when a conflict between the later and the former arises.

⁷⁴ Some authors have argued that only the clarification of the WTO agreements should be made in accordance with the customary international law. Thus, they doubt that the provisions of VCLT, apart from the rules on interpretation, would fall within the ambit of customary international law (including Article 41). However, the one of the key points expressed in this thesis is that the WTO is not a self-contained mechanism and it “falls back” on the general system of international law. Hence, as long as a certain rule of international law has not been contracted from the WTO treaty, these rules will apply implicitly to WTO.

In this context, Pauwelyn (2001, p. 54) noted that:

Even if in WTO the rights and obligations are derived from the multilateral treaty, the system of WTO countermeasures provides proof of how “bilateral” in nature the WTO still is, as countermeasures take the form only of state-to-state “suspension of concessions or other obligations,” not collective sanctions.

Here one may say that such a state of affairs creates little incentive for the WTO Members to comply with their obligations. This is valid not only in the context of enforcing the WTO provisions on RTAs but for the entire WTO enforcement mechanism. Hence, a reform in this direction is equally paramount whereby Members should on the one hand to multilateralize the sanctions under WTO and on the other, the implement a system of retrospective compensations.

3. THE ECONOMIC IMPLICATIONS OF GATT ARTICLE XXIV

This chapter will discuss the relationship between economic theory and the provisions of Article XXIV. Thus it will look at the economic theory developed in relation to the RTAs. Moreover, it will examine whether the RTAs compatibility with Article XXIV should consider the welfare implication of such arrangements and whether Article XXIV, as it stands today, can be stretched to accommodate the reasoning of the economic theory. In the opinion of some authors Article XXIV should be amended in order to accommodate the economic theory developed for RTAs where as some others believe that reflecting or reading the developed economic logic with Article XXIV may not necessarily mean less trade diversion. In this context, this chapter will also take up the analyses of the arguments supporting the above ideas.

3.1 The economic theory in relation to RTAs

During the negotiation process of Article XXIV, the U.S. draftsmen viewed customs unions and free-trade areas as constituting movements towards free trade whenever internal tariffs were completely eliminated on substantially all trade. The approach to the issue has however changed with time and as Dam (1970, p. 283) pointed out:

...it is clear that this view is much too simple. Indeed, when one examines with care functions of freer trade, it becomes clear that customs unions or free-trade areas complying fully with the requirements of paragraph 5 through 8 of Article XXIV may be strongly protectionist in effect.

In order to come up with a clearer view on the above finding, one should acknowledge the economic rationale behind RTAs as envisaged in GATT Article XXIV and look on the welfare implications arising therewith for both members and non-members.

It is claimed by various authors that there is not much economic sense behind the very high internal trade requirement as envisaged in GATT Article XXIV:8. In this context, Mathis (2002, p.102) pointed out that:

Since any agreement so qualified [*i.e.* qualified to meet the internal requirement of GATT Article XXIV:8] may be more trade diverting than a more partially preferential arrangement, a type of divergence between one interpretation of the legal text and the economic objectives is presented.

The above statement made by Mathis is in fact based on the economic theory developed up till now in relation to RTA. It appears from above that the main concern with the RTAs is whether they divert or create trade, whereby the objective running in line with welfare enhancing endeavors is to create trade (or not to divert it). Following the above, it has been argued that a lower internal trade standard would be less trade diverting (or even trade creative). This theory was initially forwarded with the appearance of Viner customs unions theory in 1950 and was later applied by Dam to the legal context. As Mathis (2002, p. 102) concluded after analyzing this theory, “the result [of the Viner’s and Dam’s interventions] has been to add an economic argument for the weakening of the conditional and definitional requirements of paragraph 8” and in all probability to contribute “to the proliferation of partial regional agreements, a result that neither would have likely approved”.

For a better understanding of Mathis’s comment presented above, one should be presented in a more detail with the Vinerian⁷⁵ concept on trade creation and trade diversion which although has been highly refined over the years, nevertheless remains central to the economics of regional trade agreements. In this context Dam (1970, p. 284) found that these twin concepts are based essentially on the notion that

⁷⁵ To elaborate, “the primary purpose of a customs union, and its major consequences for good or bad, is to shift sources of supply, and the shift can be either to lower-or to higher-cost sources, depending on circumstances.” (Viner cited in Mathis 2002, p. 103)

the function of trade (and, in particular, the function of eliminating trade barriers) is to promote a more rational allocation of resources in the world economy.⁷⁶

According to Viner, trade creation occurs when a lowered barrier between member countries result in one of these countries importing goods that otherwise would be produced at home (or not produced at all). What happens is that consumers enjoy a greater range of goods at lower prices when their country joins an RTA. After all, as the member countries of the RTA reduce trade barrier among themselves, the price of intra-regional imports falls, which then stimulates demand for these imports. Thus, trade creation ought to result from demand stimulation caused by the drop in trade barriers.⁷⁷

Viner noted that trade creation generates efficiency gains for the member countries, inasmuch as it encourages goods to be produced wherever costs are lowest within the RTA. It can also benefit outsiders-by increasing demand for related intermediate and final goods. On the other hand, trade diversion occurs when the preferential treatment causes a country to replace imports from the rest of the world with imports from a partner country. It can also be harmful to the importing country: goods that could be purchased from the rest of the world at a low cost are instead procured from a regional source at a higher cost (Bhala 2001, p. 631). This effect is expected because of the elimination of barriers among only the RTA member countries as the non-members will not benefit from the intra-regional tariff cuts. Consequently, in addition to the welfare implications on the members within the RTA there are welfare effects on the countries which are not party to the particular agreement. This is

⁷⁶ As Dam (1970, p. 285) stressed in this context it should be born in mind that the Vinerian analyses on trade creation-trade diversion is incomplete as his analyses is limited only to the so called production effects. He did not however contrast the analyses with the consumption effects, which represent the impact of regional arrangements on consumption.

⁷⁷ Certainly, there are hidden assumptions here: consumers are motivated solely (or primarily) by price in deciding what to buy, and the goods produced within or outside RTA are substitutes. Whether these assumptions are valid depends on two key empirical measures: the elasticity of demand, and the elasticity of substitution, respectively (Bhala 2001, p. 639).

explained by the fact that when preferential access induces a member country to import from another member instead of importing from an outside source, the outside country suffers a decline in demand for its exports. It implies that consumers in the member countries are likely to shift to the now lower-priced intra-regional imports, and away from the relatively higher-priced substitute products they formerly bought from non-member countries. In other words, what was imported from non-members before will be imported from members. The shift of imports from outside the RTA to a partner country is, of course, trade diversion from the outside countries.

Thus, before the Vinerian intervention in economic theory it was believed that all customs unions were economically beneficial. The trade creation- trade diversion analyses presented by Viner has for the first time proved that this was not necessarily the case, as:

If the customs union is movement in the direction of freer trade, it must be predominantly a movement in the direction of goods being supplied from lower money cost sources than before. If the customs union has the effect of diverting purchases to higher money-cost sources, it is then a device for making tariff protection more effective (Viner 1950 cited Mathis 2002, p. 104).

Moreover, he contested the need for a high internal trade requirement in Article XXIV, concluding that in an incomplete liberalization within the RTA may be in fact less trade diverting than a fully liberalized one. Moreover, and this is the key in our analyses, Viner pointed out to the absurdity of retaining a legal distinction between the minimal difference of 100 percent preference and lesser marginal preference (Mathis 2003, p. 104). In this context Viner asserted:

Free-traders sometimes in almost the same breath disapprove of preferential reduction of tariffs but approve of customs unions, which involve 100 per cent preference, and this is the position at present of the United States Government and the doctrine of the Havana Charter. If the distinction is made to rest, as often seems to be the case, on some supposed virtue in a 100 per cent preference, which suddenly turn to maximum evil at 99 per cent, the degree of evil tapering off as the degree of preference shrinks, it is a distinction as

illogical, the writer believes, as this way of putting it makes it sound (Viner 1950 cited Mathis 2002, p. 104)

Hence, the divergence between the law and economics in Article XXIV stems from the intervention of the Viner's theory as presented above. However in order to criticize the drafters of GATT, it should be born in mind that such intervention was made only after GATT entering into force in 1947. This has induced some authors to assess Article XXIV as being outdated and to have it scrutinized against Viner's argumentation above.

It was Dam in 1963 that for the first time carried out this exercise looking at the requirements set out in Article XXIV and comparing them against Viner's proposition as exposed above. As a result Dam (1963, p. 635) concluded that Article XXIV required revision in order to accommodate Viner's intervention. In this context he suggested to change the interpretation of Article XXIV in order to read into it the trade creation standard as a precondition for RTA qualification as follows:

....to interpret paragraph 4's requirement to provide for a trade creation standard, and effectively, to raise the paragraph into the position of an independent legal requirement. Implicitly, this would necessary supersede the coverage requirements expressed by paragraph 8. It would also suggest a reversal of the examination sequence in order to impose paragraph 5 as the leading factor for qualification. This because the result to be achieved would be placed upon the final structure of barriers as to non-members, rather than upon the initial qualify of internal free trade to be obtained by the regional parties at the outset. Amended in this way, qualified regional grouping would then serve the purpose of being a movement toward free world trade by being individually render as trade creating, or rather non trade-diverting.

Every since the emergence of Viner's theory on customs unions, it has dominated to some extent the discussions on RTA compatibility with Article XXIV. However, the above suggestion on Article XXIV revision offered by Dam has been criticized by Johnson (1976, p. 31) who is a strong supporter of the unconditional multilateralized MFN treatment. Thus, he argued that:

If you pay your membership dues to the club you are entitled to decent treatment as one of the paid-up members...[thus], it seems the wiser course no to devise further exceptions to the principle or rewrite it, but instead to improve the framework of international economic relations within which countries receive non-discriminatory most-favored-nation treatment.

However, the post-Vinerian discussions on the RTA compatibility with WTO did not follow Johnson argumentation, members being concerned more with the end result of regionalism, in particular whether it was expanding trade and less with the value offered by the MFN clause under the WTO (Mathis 2002, p. 107). In other words, members continued to look at the possibility of introducing some changes to Article XXIV in order to accommodate the trade expansion concerns.

3.2 Economic theory continued

Kemp and Wan are the two other economist who later introduced a new dimension to the economic approach to GATT Article XXIV as presented by Viner. According to Bhagwati and Panagariya (1996, p. 86), the Kemp-Wan contribution consisted of showing, as a “possibility theorem” that, “one could always construct a welfare-improving CU among any subset of countries while the non-members were left at their initial welfare.” The result of the theorem is elementary but, as Kemp and Wan (1976 cited Mathis 2002, p. 76) found their theorem is fundamental for understanding to potentialities of RTAs. Thus, according to them one must:

...temporarily, hypothetically freeze the imports and exports between members and outsider countries at their pre-integration level. Next we reduce or eliminate any pre-existing barriers to trade among the member countries, and let internal prices adjust freely so as to equate supply and demand of each item, including in the supply-and-demand accounting the amounts being trade with the rest of the world. By the classical gains-from-trade argument, this reallocation makes the member countries better off (though compensatory payments may be needed from one member country to another) (McMillan 1993, p. 293).

The new theory on CU restores the pre-Vinerian intuition that a CU should be welfare-improving. Consequently, this theory was employed by McMillan who similar to what Dam has done in respect to Viner' theory, made an attempt to stretch the theorem to GATT Article XXIV provisions.

Thus, McMillan proposes a simple test of admissibility of the RTAs under Article XXIV which is: "does the bloc result in less trade between member countries and outsider countries? If the answer to this question is no, then the RIA is consistent with open trade" (McMillan 1993 cited Bhagwati 1996, p.36). Thus, McMillan also acknowledges that there are "broad systemic reasons" for the internal trade requirement, but as he has concluded on this issue, the final test to be applied should refer first to the position of non-members regardless of whether or not internal trade is made free. In other words, McMillan suggests that paragraph 5 should precede the analyses of paragraph 8 of GATT Article XXIV.⁷⁸

Although appealing, however the new theorem induces further divergence with legal provisions of GATT Article XXIV (Mathis 2003, p.107). Bhagwati (1996, p.38) has criticized this approach arguing that the test suggested by McMillan would imply an aggregation posing some obvious analytical problems. Moreover, the problem with the operational significance of the Kemp-Wan argument is that it really is an existence argument, without any structure being put on it within the context of a specific model so that we can develop intuition about what the external tariff structure fore such Kemp-Wan CU would be. Consequently, he sees little prospect of it being effectively used to exclude any proposed CU or FTA.

⁷⁸ See Chapter 1 analyses.

In answering the question whether the McMillan's proposal can be stretched to Article XXIV for assessing the RTA compatibility, one should turn to Article XXIV:4 and see whether the suggestion can be read in. Thus, the provision reads as follows:

While Contracting Parties, "recognize the desirability of increasing freedom of trade by the development...of closer integration between economies of the countries parties to such agreements. *They also recognize that the purpose of the customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other Contracting Parties with such territories*" (italics added).

In this context, it should be noted that the preamble of paragraph 5 grants the Article XXIV regional exception *provided that* the general incidence of duties and regulations of commerce shall not be higher or more restrictive on the whole. This suggests that an economic analysis should be undertaken to determine such an overall effect. As Mathis (2002, p.111) concluded, it does not suggest however that the condition to meet should turn upon whether the result is trade creating or trade diverting. Consequently, a finding that a customs union was trade diverting on balance would not raise an argument that paragraph 5 requirements were not being met. Concluding his analyses, Mathis (2002, p.112) found that:

What one concludes is that whether a customs union or free-trade area is diverting trade may well have negative implications for the welfare of non-members and for the expansion of world trade. This consideration, as important as it is does not however equate with a conclusion that such agreements are incompatible with the trading system, at least as this concept is prescribed by Article XXIV. Thus, while the rules of the trading system regarding discrimination are established by the conjunction between Article I and XXIV, the result being sought is not only concerned with trade expansion.

In other words, as it stands today Article XXIV does not accommodate the Kemp and Dam theorem as elaborated by McMillan. In other words, it would be too daring to read the trade creation criterion as a standard for qualifying RTAs under Article XXIV.

3.3 Should Article XXIV be modified to accommodate the economic theory?

Before looking on how Article XXIV could be amended to address the trade diversion concerns it should be noted that along the debates over this issue, quite frequently the high internal requirement has been defended. Such defense stems from a few justifications that have been provided in its favor by a few authors. In this context, it has been suggested that the high internal requirement in Article XXIV:8 tends to eliminate the possibility of only trade-diverting preferences being selected. Thus, Hudec (1993, p.155) presents this justification as follows:

In addition, once governments are allowed to select some products and not others, political forces will inevitably exert enormous pressure to choose trade-diverting preferences first. Trade-diverting preferences are the ones that result in the greatest net political gain for governments; the political gains arise from pleasing local producers who displace third-country producers, while political losses are entirely avoided because third-country producers do not vote.

Similarly, the idea has been expressed by Viner who for the first time introduced the idea that RTAs could be trade diversionary. Although finding no economic logic for a high internal trade requirement, he admitted that there may be space for selective preferences whenever a lower standard would be allowed. Equally, Roessler (2000) argued in the same line that “domestic protectionist’s pressures will tend to favor trade diversion over trade creation, and governments negotiating RIAs will therefore be under pressure to avoid preferences in those sectors in which they are likely to increase imports”. Thus, as Mathis (2002, p.115) concluded on these justifications:

...it appears that the internal trade requirement of Article XXIV:8 has been cited to appear to serve a trade creating goal, albeit within a limited framework, and from a view point based upon the prospective conduct of regional and some natural inclination to select injurious preferences.

A second justification for the internal trade requirement as it stands is the prevention of the RTAs proliferation. Thus, it is believed that the WTO Members are more likely

to accept the MFN deviation reflected in Article XXIV when the commitment to liberalize trade among them is serious. In other words, if they indeed comply with the high internal trade requirement set out in the Article XXIV (Mathis 2003, p.116).

However, the above justifications for the substantially-all-trade requirement have not been short of counterarguments. In this context, it was suggested that even with a partial and selective liberalization of sector among RTA members which will not lead to regional trade creation; this would however not reduce the welfare of non-member countries. Following this logic, Mathis (2003, p.116) concluded that “if such exchanges are economically neutral, *i.e.* if they do not hurt anyone, then there is no particular reason why GATT Article XXIV should be viewed as preventing them from occurring”. Further the argument on selective sector liberalization can be easily defeated by McMillan suggestion on the preservation of trade volumes for non-members. Similarly, the prevention of proliferation argument can be also defeated by the same argument above.⁷⁹ Thus, “this seems to go to the point of Kemp/Wan construction that it is possible to acknowledge the benefits of regional integration without reducing world welfare” (Mathis 2002, p. 117).

When looking at the Article XXIV provisions with the view to determine whether it could be modified in order to address the trade diversion concern, Bhagwati (1996, p.36) suggested that a desirable discipline to impose on CUs and FTAs would be to require simultaneous reduction of external tariff (implicit and explicit), *pro rata* to the progressive elimination of internal trade barriers. Thus, he found that a possible way to ensure this is by modifying Article XXIV to rule out FTAs with diverse tariffs by members and to permit only CUs with common external tariffs⁸⁰.

⁷⁹ That appears to run hand in hand with the Kemp-Wan theory which acknowledges the possibility of constructing RTAs which do not divert trade.

⁸⁰ As in his opinion CUs are less trade diversionary than FTAs.

As an alternative to the above and a surer option is to insist on CUs but also write into Article XXIV the requirement that the lowest tariff of any union member on an item before the union must be part of the common external union (Bhagwati 1996, p. 36). This is in fact the recipe provided by Bhagwati when criticizing the Kemp/Wan theory referred to in the previous subsection.

However, Bhagwati (1996, p. 36) recognized that the above suggestions alone are not able to fully ensure that trade diversion will not take place as a result of RTAs creation. In this context, it was recognized that nowadays we live in the area of various trade mechanism targeting unfair trade practices which are widely used by governments. Thus, he found that “trade creation can degenerate rapidly into trade diversion, when AD actions and VERs are freely used” and their use must be taken care of along with the above propositions.

In the same context, McMillan (1993, p.300) suggested that for Article XXIV to become more workable its requirements must be phrased not in terms of height of tariffs but in terms of trade volumes, that is by looking at the trade consequences of the restrictions rather than trying to measure their effect on domestic prices. Thus,

A proposed RIA, in order to get GATT imprimatur, would have to promise not to introduce policies that result in external trade volumes being lowered. And, if after some years the RIA is seen to have reduced its imports from the rest of the world, it would be required to adjust its trade restrictions so as to reverse this fall in imports.

However, McMillan (1993, p.307) recognizes in this context that a possible disadvantage of focusing on trade volumes instead of tariff levels is that, in principle, tariff levels can be observed in advance, whereas trade volumes can be measured only after the RIA has been in existence for a few years. Yet, the implications of a new trading arrangement for trade volumes can, however, be predicted using an

economic model⁸¹. Similarly, he suggests improvements in the adjudication of the RTAs compatibility in way that GATT panels should be allowed to hear expert testimony about the predicted or observed effects of the agreement on trade volumes.

In contrast to above findings, Roessler (2000, p.93) is of the opinion that the GATT's substantially-all-trade rule for regional agreements could not be replaced by a requirement that such agreements increase world welfare because such a requirement would be at odds with the political nature of the GATT provisions on regional agreements and could-given the unpredictability of the welfare effects of regional agreements-not be transformed into a rule of conduct. Thus, in order to ensure that the regional and multilateral approaches to trade liberalization are fully complementary, the parties to regional agreements should explicitly retain all their rights under GATT legal system, including their rights under the GATT dispute settlement procedure. This last idea expressed by Roessler is closer to McMillan's concern on trade preservation.

Moreover, the political side of the RTAs has been also taken up by Baldwin who pointed out the RTAs creation are not always driven by the welfare implications alone. Quite often they are backed up by strong political considerations. And as Mathis (2002, p.118) found on the same issue:

...from this it is drawn that the core justification for non-discrimination, and for its specified regional exception, is not economic in rationale. It rather reflects the resolution of an historical problem of international diplomacy by the use of a legal rule employed within a contractual undertaking.

⁸¹ That it is feasible to do *ex ante* empirical studies predicting the effect of a proposed RIA on trade volumes is illustrated by the analysis of the addition of Spain and Portugal to the EC by Sawyer and Sprinkle (1998) (McMillan 1993, p. 304).

Moreover, the economic studies indicate that the relationship of creation-, diversion- and welfare-creating effects is a complex one and does not permit simple answers. Much depend on individual circumstances (WTO Report 1995, pp. 44-45).

Hence, although there are some sound suggestions as to a more economic rationale Article XXIV, one should recognize that the political rationale may after all come on the first place whenever countries envisage their conclusion. In other words, this may imply that the welfare concerns of the economist as presented above may be overridden by political rationales.

CONCLUSION

The objective of this thesis work was to present the problems arising in connection to Article XXIV of GATT which is also referred to as the regional trade arrangement exception. As presented in the above analyses the Article XXIV provisions are vague, at the moment, leaving scope for wide and biased interpretation on behalf on RTA participants. Among other authors, the seriousness of the loopholes with Article XXIV has been pointed out by Dam finding that “today it is clear that if a single adjective were to be chosen to describe Article XXIV, that adjective would have to be “deceptive”” (Dam 1970, p. 275).

Similarly McMillan has stressed, in relation to Article XXIV, that any law that is rarely complied with is a bad law. Thus, “that Article XXIV is ineffective is explainable, at least in part, by the fact that it is subject to a wide range of interpretations. A rule that was on the other hand, simple and perceived to be fair would have a reasonable chance of being obeyed by GATT contracting parties”(McMillan,1993, p. 301).

The above analyses centered on the systemic issues as identified by the CRTA (and pre WTO within Working Parties) within the numerous discussions targeted at improving the functionality of Article XXIV.

Moreover, the Vienna Convention on the Law of Treaties has been analyzed in order to identify its role in clarifying both the meaning of the terms used in Article XXIV and the relationship between WTO law and the regional trade arrangements concluded by a subset of WTO members (the *inter se* agreements). Having carefully analyzed its relevant provisions, one may conclude that the Article XXIV will remain the controlling provision of the RTAs concluded by any such subset of WTO members.

Although economists claim that there is not much of economic rationale behind GATT Article XXIV, it should be noted that the economics with the RTAs is most likely to be

overridden by political considerations. As Cottier (1996, p.15) observed in this context, each preferential agreement is unique -not only do the working provisions vary, but the reasons for making the agreement itself differ.

Thus, based on the analyses in the above chapters the following recommendations could be made in respect to GATT Article XXIV improvement:

1) In the part of the systemic issues relating Article XXIV the WTO members should endeavor to clarify the meaning of the substantially-all-trade requirement (popularly called internal trade requirement) which is a highly contested terms therein. Similarly, as presented in Chapter 1, there is a long list of other systemic issues that need clarification referring but not limited to *the general incidence of duties and other regulations of commerce, other regulations of commerce and other restrictive regulations of commerce, the relationship between paragraph 4 and paragraphs 5 through 9, exhaustive vs. non exhaustive listing in paragraph 8 (b)*, that needs clarification. Additionally, the contentious terms with Article V of GATS which has been partially addressed in this thesis must be clarified in parallel with the relevant terms under GATT Article XXIV terms.

2) As has been suggested by numerous authors, the voting procedures within CRTA require fundamental revision. Moreover, the place and role of the DSU mechanism for WTO RTAs consistency has also to be established. As it stands today, the CRTA approves its decision by consensus and reports will be adopted in both cases: when members unanimously agree on the consistency of the notified RTA with WTO and when they disagree, reflecting the divergent views of the members. Thus, it is clear that the current voting system with the CRTA does not allow clarification sought in respect to the substantial issues with Article XXIV GATT and V GATS. The rule continues to be a major hurdle to reach concrete outcomes when reviewing RTAs

within CRTA. One suggestion in this respect would be to either sacrifice the consensus rule of the CRTA or find a new voting formula, or to assign this attribution to a totally independent body (non-WTO members). Alternatively, given the enhancement of the role of the dispute settlement, the clarification of the substantive issues could be equally employed by WTO panels/appellate body more often. The remaining question is however to what extent the adjudicating body can take on the board the RTAs compatibility examination. Here, it should be noted that in contrast to Panel's findings in Turkey Textile case, the Appellate Body had expressed the view that the WTO adjudicating body could examine such compatibility provided the two conditions were met as found therein. However, considering the binding nature of the WTO Panel/AB reports only among the parties to the dispute the extent to which this finding will be used in the future is questionable.

3) When discussing about improved enforcement for GATT Article XXIV and GATS Article V one should look at the incentives the WTO members currently face to enforce the rules. As discussed above the non-compliant RTAs would only trigger claims on MFN treatment, compensation or retaliatory measures by affected third Members. However, as long as the enforcement is confined to only the above remedies, members there may have little incentive to comply.⁸² But most importantly, WTO members must seek to clarify the consequences for non-compliant RTA agreements and to what extent their inconsistency would affect their validity both between the parties thereto as well as between the later and third countries. In this context, one option of strengthening the compliance with Article XXIV and GATS

⁸² This is also coupled by the fact that as it stands today the remedies available under WTO dispute settlement mechanisms the compensation would be granted only to the parties to the dispute and only on retrospective basis. Thus, this even further weakens the incentives of members to comply as the price to be paid is obviously diminished.

V would be to request WTO members to commitment themselves to refrain from WTO incompatible agreements.

4) However, the current explosion of the RTAs can not be disassociated from problems inherent with the current of decision making process in the WTO. Thus, many claim that RTAs proliferation is related to the lack of progress of the multilateral negotiations. From this perspective the consensus rule has been criticized for no longer offering expected outcomes in negotiations. Hence, the review of the consensus rule under WTO could add to both moving ahead with multilateral negotiations, thus securing more MFN treatment among members and to the improving of the enforcement of the existing provisions.

5) Last but not least, GATT Article XXIV and GATT V can be improved in light of the developed economic theory as suggested in Chapter 3 above. However, in giving course to such modification or interpretations, of the respective provisions WTO members should consider that RTAs are very often driven by political rational, hence, members may resist any welfare analyses test therein.

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